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Brief of East for D. E.

Office Supreme Court U. S.
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# In the Supreme Court of the United States.

OCTOBER TERM, 1900.

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## The Guarantee Co. of North America

vs.

## Mechanics Savings Bank and Trust Co., to use of James Pryor, Assignee.

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In Error to Circuit Court of Appeals for the Sixth Circuit.

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BRIEF OF

EDWARD H. EAST,

SOLICITOR FOR DEFENDANT IN ERROR.

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MARSHALL & BRUCE CO., NASHVILLE.

# In Supreme Court of the United States

## OCTOBER TERM, 1900.

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**Guarantee Company of North America,**
PLAINTIFF IN ERROR.

v.

**Mechanics' Savings Bank and Trust Company,**
DEFENDANT IN ERROR.

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IN ERROR TO THE CIRCUIT COURT OF APPEALS
FOR SIXTH CIRCUIT.

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*May it please the Court:*

This record is brought to this court by certiorari to the Court of Appeals for the sixth circuit, to review a judgment of that court affirming, with some modification, the judgment of the Circuit Court of the United States for the Middle District of Tennessee, in favor of J. J. Pryor, assignee of the Mechanics' Savings Bank & Trust Company, against the Guarantee Company of North America, a Canadian corporation, for the amount of two bonds given by plaintiff in error, insuring the bank against loss by dishonesty of its teller, John Schardt, and the same person

as its cashier, he having filled the two positions in succession.

The opinion of Circuit Court is in 68 Fed. Rep., 459.

The opinion of Court of Appeals affirming is in 80 Fed. Rep., 766.

The opinion on petition for rehearing in 82 Fed. Rep., 545.

Opinion of Supreme Court is in 173 U. S., 587, remanding to Circuit Court.

Opinion of Circuit Court of Appeals on second hearing, — Fed. Rep., ——, and in this record.

## IN RE OF TELLER'S AND COLLECTOR'S BOND.

The teller's bond is dated January 16, 1888, and was renewed from year to year until January 1, 1893. This bond was in the penal sum of $10,000, for which the bank paid $100, and, to effect a continuation of said bond for ensuing years, a like consideration was to be paid by the bank annually, which was done, and the bond was continued current until the sixteenth day of January, 1893.

The condition of the bond is:

"To make good and reimburse to the employer such pecuniary loss as the employer shall have sustained by the *fraudulent* acts of the employe, in connection with the duties of said office or position, or with any other duties assigned to him by the employer in the said service, committed by him, and discovered during the continuance of this bond, and within six months from the employe ceasing to be in said service."

There are many conditions and provisions attached to this bond, and agreed to be observed, not necessary to notice in this litigation. I here quote such only as it is insisted are necessary to the adjudication of this case, and are agreed to be "observed and binding as a part of this bond:"

"That this bond is *issued* and *renewed* on the express understanding that the employe has not, within the knowledge of the said employer, at any former period, either in this or other employment, been guilty of any default or serious dereliction of duty.

"That the employer shall observe, or cause to be observed, all due and customary supervision over the said employe for the prevention of default, and if employer shall, at any time during the currency of this bond, condone any act or default on the part of the employe which would give the employer the right to claim hereunder, and shall continue the employe in his service, without notification to the company, the said company will not be responsible hereunder for any default which may occur *subsequent* to said act or default of said employe so condoned.

"That the employer shall at once notify the company, on his becoming aware of the said employe being engaged in speculation or gambling, or indulging in any disreputable or unlawful habits or pursuits.

"That there shall be *an inspection* or audit of accounts or books of the employe on behalf of the employer at least once in every twelve months from date of this bond."

The bond also declares in its preamble the following:

"And, whereas, the employer has delivered to the company a certain statement, and it being agreed and understood that such statement constitutes an essential part of the contract hereinafter expressed."

This statement is nowhere identified or more definitely pointed out.

The Guarantee Company contends that the paper referred to is the one signed by C. W. Peden, the then cashier of the bank, as this was the only paper delivered to the company either before or contemporaneously with the execution of the bond, and which consists of questions and answers.

On this theory, I now quote such questions and answers as are supposed to enter into this lawsuit:

Question 8. What is your custom in regard to frequency of *inspection?* Are they at stated periods or irregular, and what is the longest time allowed to elapse between inspections?

Answer. Every quarter.

Question 9. Has the bank a duly appointed and authorized inspector or inspectors. If not, by whom are the inspections made?

Answer. The finance committee.

Question 18. In the event the employe filling the post of teller, how often, and by what officer will the teller's cash be checked and counted?

Answer. By finance committee quarterly.

Rec. 87, 88.

The questions and answers are concluded by this declaration:

"I hereby declare that the answers and representations above made are true, and that I am not aware of any matter or thing affecting the character or reputation of the applicant which should create any doubt as to his reliability or trustworthiness.

"Dated at Nashville, Tenn., this 21st day of January, 1888. (Signature) C. W. PEDEN,

"Cashier, on behalf of bank."

Rec. 88.

There is no effort in this bond to make these statements

and declarations warranties. There are no warranties in this bond.

The teller's bond was renewed from year to year by the payment of the $100 by the bank, and without any specific questions or answers additional, but before the bond was renewed each year the defendant company sent out to its patrons a printed circular, in which, among other things, was the following:

"It is necessary, before the bond can be renewed, that you obtain the certificate on the back hereof, by your president or cashier, and on its return with remittance of the premium, the renewal can be immediately effected."

Rec. 89.

The certificate on the back was filled up and signed by the cashier, and, among other things, it stated that the accounts of said teller, Schardt, had been *examined* and *verified* by the finance committee of said bank, and the bond was not renewed any year until this certificate had been made out and delivered to the defendant company.

Rec. 89.

This statement only applied to the teller's bond.

The embezzlements as teller and collector commenced September 12, 1890, and continued during the currency of the several bonds, successively, to January 1, 1893, when Schardt became cashier, vice Sykes, resigned.

The embezzlements, as shown by the experts, are subdivided, as follows:

| | |
|---|---|
| From Sept. 1, 1890, to Jan. 16, 1891 | $ 5,879.34 |
| From Jan. 16, 1891, to Jan. 1, 1892 | 22,290.00 |
| From Jan. 1, 1892, to Jan. 1, 1893 | 50,649.90 |
| Total (record, page 28) | $77,819.24 |

## HOW EMBEZZLEMENTS WERE COVERED ON THE BOOKS.

These various embezzlements were covered on the books of the bank, and detection prevented:

1. By false additions.
2. Failure to enter notes discounted.
3. Failure to enter money collected.
4. Failure to give proper credits to depositors on the books of the bank.
5. Failure to credit on the books of the bank interest paid on notes.

Rec. p. 29, q. 4; Rec. 41, q. 10.

Nearly all of the embezzlements were covered on the books by misstating the amount due depositors upon the books kept by Schardt.

Rec. 32, q. 14; q. 23, p. 33.

The expert, McEwen, and others, when asked if these abstractions and embezzlements were easily detectable from the books of the bank, testified:

"They could easily have been detected by an expert bookkeeper. His falsifying of the books was done, in main, in false additions on the cash book, and whenever this was done he nearly always falsified the general account of individual depositors on his general ledger, to correspond with the errors made on the cash book. A few of his false additions on his cash book were covered up by falsifying one or more of his other accounts on his general ledger. The amount shown as due individual depositors by the account on the general ledger, was far less than that actually shown to be due by the pass books of depositors."

Rec. 29, q. 5.

The two expert bookkeepers (McEwen and Jennings), with their assistants (Fisher and Northern), were engaged in this work "several months."

Rec. 29, q. 7.

It was necessary to refer to various and different books. (Rec. 29, ques. 10.) All pass books had to be called in. (Rec. 29, ques. 10.) In some instances no deposit tickets could be found.

Rec. 29, q. 11.

BOOKS KEPT BY THE BANK (Rec. 30, ques. 4.)

1. Individual ledger, kept by a clerk.
2. General ledger, kept by Schardt until made cashier.
3. Cash book, kept by Schardt until made cashier.
4. Daily balance book, kept by Schardt until made cashier.

Pryor gives the books kept by the bank, as follows: General ledger, individual ledger, cash book, deposit register, check register, discount register, and such auxiliary books as experience showed to be necessary.

Rec. 59, q. 10.

The individual ledger showed the deposit account of each individual depositor.

General ledger shows every account in the bank except that of individual depositors, viz.: Demand loans, discounts, bonds, stocks, and such. It has also an account showing in totals the deposit made and checked out each day by individual depositors. This book was kept by

Schardt from beyond 1890 to the time the bank closed (April 17, 1893).

The cash book shows the same things as the general ledger, except that instead of putting the business of each day under various accounts, they are grouped together on one page in the cash book, and shows at a glance the entire business transacted by the bank during the day.

This witness testified that the fact that Schardt was permitted to keep the general ledger and act as general bookkeeper in the bank, greatly increased his facilities for embezzling the funds of the bank. (Rec. 32, ques. 16.) Also, he was asked: "Would it have been possible for Schardt to have embezzled funds of the bank to any extent without detection if he had not been permitted to keep the general ledger?" The answer is: "It would not have been possible for him to embezzle the funds in the manner he did if he had not been permitted to keep the general ledger and balance book." (Rec. 33, ques. 20.)

It will be observed that what is designated herein as the teller's bond, was given upon the idea that Schardt had been assigned to the office or position of teller and collector (rec. 10), and covers any pecuniary loss which the bank shall sustain in connection with the duties of the said office or position, or with any other duties assigned him by the employer in said service. (Rec. 10.)

This witness when asked concerning a trial balance book, said: "I saw a book of that character when I went in there, but it was incomplete, the balances not entered up, and I paid no attention to it, and I do not know for what years they were taken off." (Rec. 33, ques. 21.)

This trial balance book was left off in 1890, by the orders of Schardt. (Rec. 62, Boensch Dep., question 6; ques. 15.)

In the examination of these witnesses, many hypothetical questions were put by the defendant as to how, and whether these embezzlements might have been easily detected had the officers of the bank suspected Schardt, and resorted to them, all of which resulted in negative answers, except as follows: One expert said: "They could, upon any day, at close of business, have taken the daily balance book showing a record of the condition of the bank at the time, and counted the notes on hand, bills receivable, bonds and stocks, and cash, and could then have verified the amount appearing to be upon deposit in other banks to the credit of complainant bank, and this would have only left to be verified the amount shown to be due depositors, and the way to verify this would have been to have taken from the individual ledger a trial balance, which would have shown the amount due depositors by the bank, and if this had agreed with the amount appearing upon the daily balance book to be due depositors, the officials of the bank would have verified his accounts as clearly as possible." (Rec. 32, ques. 12.) This, he said, should not, in a bank of that size, have taken over twelve hours. (Rec. 32, ques. 13.)

The other expert (Jennings), said: "No person not an expert bookkeeper could have found many of those manipulations, but it would not have been difficult for any one who could add columns to have seen some of these false

additions, which would have resulted in causing suspicion that some wrong was intended."

Rec. 41, q. 11.

Jennings also testified, in respect to the time it would have taken: "Of course it depends upon the rapidity of the work of the bookkeeper. I should think twenty-four to thirty-six hours would be sufficient for an average bookkeeper to do that work." (Rec. 42, ques. 9.)

## BY-LAWS OF BANK AS TO DUTIES OF TELLER AS BOOKKEEPER.

"The teller shall also be the general bookkeeper of the bank."

The evidence shows that no system of bookkeeping will detect or prevent embezzlements, including taking trial balances, and that it is not possible to ascertain the financial condition of a bank without stopping the bank for a time, call in all the pass books, and have an expert go through the whole.

Rec. 61, dep. of A. W. Harris.
Rec. 71, dep. of Duncan, q. 33.

The evidence shows that in small banks it is customary for the teller to keep general ledger.

Rec. 69, q. 5, et seq.; Rec. 71, q. 27.

It cannot be contended, in view of this contract, that it was wrong to allow Schardt to keep the book known as general ledger, and that Guarantee Company can say successfully that this enabled Schardt to commit and conceal

his embezzlements. The contract prepared by the Guarantee Company, and submitted to the bank, is "to make good and reimburse to the employer such pecuniary loss as the employer shall have sustained by the fraudulent acts of the employe in connection with the duties of his said office or position, or with any other duties assigned to him by the employer in the said service."

The proof shows that it is not customary for financial committees, in examinations, to go through original entries on the books, but it is customary for them to accept statements made by cashiers, officers, and clerks.

Ducan dep., Rec. 71, q. 31.
McLaughlin dep., Rec. 68, cross question 2.
A. W. Harris dep., Rec. 61, qq. 3, 4.

There was, at all times, a financial committee consisting of five members; generally, three acted.

The evidence shows conclusively that the finance committee made quarterly examinations into the bank's condition, and also semi-annual examinations. The main purpose of the latter was to ascertain the ability of the bank to pay a dividend. The mode and extent of these examinations are stated differently, but substantially concur. Eatherly says:

"Mr. Schardt made out a list of assets of the bank, and that list was taken charge of, generally, by myself and a portion of the finance committee. We went to where the securities were kept, and took them to the directors' room, or rear part of the bank, and compared them with the amounts given on the list, to see whether they corresponded. We examined the collateral, or evidences of them, to see if they were there. We counted the cash on hand, and had generally a certificate from the

banks where we deposited, to the amounts in those. We then compared the footings with the amount as shown on the daily balance sheet or balance book, to see whether they agreed with them. We found no discrepancies except in cash on hand in a few instances. Generally, there was a discrepancy of a few dollars between the money on hand and the amount shown by the daily balance sheet. Sometimes it was a deficit and sometimes a gain, but generally a deficit."

Rec. 42, 43. McEwen's Dep., 75.

This custom was habitual and continuous.

In addition to these quarterly examinations, annual reports were submitted to the directors by the cashier. The president, or some one or more of the directors, was present in the bank at all times.

Rec. 43.

Eatherly admitted that had the finance committee procured from the individual bookkeeper the total amounts shown by his books to be due individual depositors, and compared it with the amount shown by the daily balance book kept by Schardt to be due individual depositors, it would have disclosed the fact that something was wrong with the books.

McEwen testified, in respect to these quarterly examinations, as follows:

"We counted all the money, or things that represented money, such as cash tickets, checks on other banks, deposits in other banks, and compared this with the statements furnished us by the cashier or teller. Then we took possession of all notes, bills, time or demand loans, or other paper showing an indebtedness to the bank, as well as collaterals, and did our best to ascertain the condition of the paper, and value of collaterals. We compared this

with statements furnished by the cashier or teller of what should be in the bank of those kinds of paper, and also compared it with the daily balance book. As we had seen all notes or bills which had been discounted by the bank, and these had been entered on the daily balance book, we would sometimes go back to it. We always took the cashier's or teller's written statement of the deposit account. We hardly ever examined original entries of deposits, but accepted this statement as making a full and fair exhibit of these. We could not have examined original entries. There were several hundred depositors, and a great many small accounts with individuals. It would have taken all our time to have done this, and but few, if any of us, were bookkeepers or accountants. We had to rely upon the honesty of the cashier for this. We did our best to ascertain the exact condition of the bank at the end of each quarter. The finance committee was the discount committee, and all paper approved by the committee was recognized by the committee at the quarterly examination. If we did not remember it we appealed to this book of original entries on the ticket. The quarterly examinations were of the same kind and character which all the banks of Nashville made, as we understood."

Rec. 77, q. 17.

"Every July and January of each year the directors and finance committee made an examination into the affairs of the bank with a view to ascertaining the ability of the bank to pay a dividend. These examinations of the directors and finance committee were as thorough as we could make them."

Rec. 77, q. 23.
J. B. Richardson dep., Rec. 79.
Rec. 81, q. 3.

The defendant company had a general agent (Cooley) resident in Nashville. It is a part of the duties of this general agent to gather information concerning applicants for bonds, and about persons already bonded in defendant company, and to transmit such information to the home

office. To this end the agent employed detectives at discretion, and took information from outside parties.

## ARGUMENT IN RESPECT TO TELLER'S BOND.

### I.

*It is said in argument by my opponent that the bank procured the teller's bond for the year 1892, and all previous years, to be renewed by representing that the employe's books and accounts had been "examined and verified," when in fact, no such thing had been done, and, had it been done, his previous defaults would have been discovered.*

I desire just here to clear the case of an obscurity which may lead to confusion and error.

When the bond was made for the year 1888, it contained the following: "And, whereas, the employer has delivered to the company a certain statement, and it being agreed and understood that such statement constitutes an essential part of the contract herein expressed."

Rec. 10.

The statement there referred to as an essential part of the contract has no reference to the statement made in the circular, above referred to, stating that the accounts and books had been "examined and verified," but refers to the statement signed by C. W. Peden, cashier, on pages 86, 87.

Stipulation. Rec., p. 86.

The statement contained in the circular sent out, before the renewals of the bond, to the effect that the books and

accounts had been "examined and verified," is no part of the original contract, and is nowhere called for in the contract, or as a condition to its renewal. It was a paper voluntarily sent out from the chief office, at Montreal, and among other things, contained the words ascribed to it on page 85 of the record, and was filled up and signed, and sent back to Montreal. The paper referred to in the body of the bond and as constituting "an essential part of the contract," is the one setting out the questions and answers as shown on pages 86, 87 of record.

## II.

I have quoted hereinbefore all the provisions and conditions of the contract, and all the duties and obligations assumed by the bank, as respects this employe, or his books and duties.

The defenses to this suit involve, necessarily, the question of the proper construction of the bonds and rights of the respective parties thereunder, rather than any conflict about the facts.

Here are contracts prepared and printed by the company, which it tenders to the public, by which it undertakes and obligates itself to indemnify and make good to its patrons any pecuniary loss occasioned by reason of the dishonesty of their employes.

The contract implies that employes will have opportunities to embezzle and steal, and that they will not avail themselves of these opportunities, or if they do, the com-

pany will make good their thefts and embezzlements to the employer.

These contracts amount to nothing if the conditions and provisos are so arranged by the use of general language, that there cannot be a theft or embezzlement for which a recovery may be had, because the employer gave the employe the opportunity to accomplish it and to conceal it.

No opportunity to accomplish the theft or embezzlement, or no opportunity to conceal it, when it is accomplished, implies no risk, and reverses the relation of the parties, as assumed in the very purpose of the contract.

The one gives a bond to indemnify and save the other against loss, and the other concedes conditions by which the bond is made practically ineffective for the purpose intended.

The Guarantee Company insures the bank against loss, and, in turn, the bank guarantees that the company shall not suffer loss, because it would give such efficient supervision over the employe and his books as will be sure to prevent loss. Hence, the premium is paid and no risk assumed.

The bond will be construed to give indemnity unless there are unambiguous, clear, and positive words to prevent it. There will be no implication against the purpose of the bond. All risks will be put upon the guarantor, in every respect, unless he has qualified it by apt and unmistakable language clearly intended for and expressive of that purpose.

## III.

## IS THE RELATION THAT OF SURETY AS GENERALLY UNDERSTOOD?

The Guarantee Company is a compensated guarantor, who, by express contract, undertakes to make indemnity, and to limit his liability. The ordinary surety is not compensated, and usually has no voice in the contract, and makes no limitations upon the extent of his liability. He signs the bond and leaves it to the law to determine the extent of his obligations, and to limit or qualify them accordingly as he has been treated. Hence, it has been held that if the obligee actively conceals facts material for the surety to know, it will operate to discharge him.

Rees v. Benington, 2 Ves. Jr., 540.
2 White & Tudor Lead Cas., 1106.
Roelton v. Mathews, 10 Clark & F., 934.
Hamileon v. Watson, 12 Clark & F., 109.

In compensated suretyships the latter prepares the contract; in its every detail determines for himself what he desires or cares to know; puts searching questions to this end; makes conditions and provisos as to his ultimate liability. He leaves nothing to the law except the effects of fraud that may be practiced upon him. In these latter days corporations are organized to be, and become compensated guarantors or sureties, for the fidelity of employes. They claim in one aspect to be strict sureties, and when sought to be held liable, invoke to their aid every principle of law or equity applicable to that relation. In another

aspect they claim to be *insurers*, and invoke to their aid all the niceties and warranties of insurance law, especially those regrettable technicalities which recent legislatures have swept away, and which so long perplexed the courts.

Strictly, they are neither the one or the other, but partake of both—are original—and must be dealt with as originals in the future.

## IV.

## "EXAMINATION AND VERIFICATION."

Our opponents insist that upon each annual renewal of the teller's bond, the company sent out from Montreal a circular to the bank, which it was necessary for some officer of the bank to sign and return, and that among many other things contained in said circular, were the following: "The accounts of said teller (Schardt) had been examined and *verified* by the finance committee," and that this was a condition precedent to the renewal. That, in fact, the account had not been examined and verified; and, therefore, it was a falsehood, and deceived the company in the issuance of the bond, being a material and important fact.

We say that the original contract made all arrangements for these renewals, and fixed in advance the terms and conditions thereof.

Its language is:

"Now, therefore, in consideration of the sum of one hundred dollars, lawful money of the United States of America, to the said company (paid), as a premium for the

term of twelve months, ending on the sixteenth day of January, 1889, at twelve o'clock noon, *and in order to effect a continuance of the currency of this bond*, a like premium hereafter to be paid to the said company on or before the sixteenth of January in each year, as a premium for the ensuing year, so long as said employer may wish to continue this bond, and the said company shall consent to receive said premiums," etc. (Rec. 10.)

Here is no reservation for either party to alter the contract, and no notice that there would be any effort to change it. On the contrary, the parties agree to annual renewals upon "the payment of a like premium *hereafter* to be paid to the said company so long as the said employer may wish to continue this bond, and the said company shall consent to receive said premiums."

Cumulative to the above, the bond recites:

"The following provisions are also to be observed, and binding, as a part of this bond. The actual payment of the premium, and its acceptance by the company, either for the issue or renewal of this bond, is essential to its currency, and a condition precedent to the right or claim hereunder."

Rec. 10.

Again, we have: "That this bond is issued and *renewed* on the express understanding that the employe has not, *within the knowledge of the employer*, at any former period, either in this or any other employment, been guilty of any default or serious dereliction of duty."

The foregoing constitute all the conditions for the annual renewal on the bond. After the expiration of a twelve month, the contract is to be renewed. As respects

*time*, a *new* contract is made, but it contains only the terms of the old contract. May says it is generally held to be a new contract upon the terms and conditions stated in the policy expired, the old application, in the absence of evidence to the contrary, serving as a basis of the new contract, and as if made at the date of renewal.

May on Ins., § 70a.

As respects the "examination and verification" of the books or accounts of this office, not one word is said in the original bond. I now quote what it does say:

"That there shall be an inspection or audit of the accounts or books of the employe on behalf of the employer at least once in every twelve months from the date of this bond."

The company had put a number of questions to the officers of the bank, which were to be, and were, answered, to ascertain, before taking the risk, the habits of the bank in respect to these very matters, such as "When was the last *inspection* of the office?" "What is your custom in regard to the frequency of *inspection?*" "Are they at stated periods or irregular?" and "What is the longest time allowed to elapse between inspections?" "Has the bank a duly and authorized inspector? If not, by whom are the inspections made?" "In the event of the employe filling the post of teller, how often, and by what officer, will the teller's cash be checked and counted?" And, to conclude it all, the contract declared in express words: "That there shall be an inspection or audit of the accounts or books of the employe, on behalf of the em-

ployer, at least once in every twelve months from the date of this bond."

This circular, which contains the words, "examination and verification," it is now claimed, requires more of the bank than was required by the original contract, or than is expressed by the words, "inspection or audit," and an effort is thus made to alter the contract in a sidewise, unadvised, and unconscionable manner.

Our contention is, that under this contract the bank was required to do certain things in respect to the books and accounts of its teller, and these things, we claim, it did, and this contract was to continue from year to year, upon the payment of the premiums, so long as the one paid and the other accepted it. At the end of the year, and when the bank had determined to continue the contract for another year, and to pay the premium, this paper, not purporting to change the contract or the duties of the bank, then past and ended, came to the bank, and hidden in it are the words, that the teller's accounts had been "examined and verified" by the finance committee, whatever these words mean. We insist that said statement, in respect to "verification," was not a condition of the original contract, as set out in the bond or guaranty; was not called for therein as a condition precedent to renewal, but was intended as a catch, slyly and cunningly devised to defeat ultimate liability, and to entrap the unwary.

We further contend that the words of the original contract are the contracting and controlling words of the parties, measured by each before executing the contract, and

fixed forever their rights and duties under *that* contract so long as it existed, as between themselves, and that its legal effect was not to add anything to the contract as a condition or provision, but should be construed in connection with and to have reference to the words, "inspection or audit," as set out in the original contract. That having required the bank to perform specific duties in the original contract, it cannot subsequently limit its liability and defeat the entire contract by requiring the bank to do those same things by using stronger words, or increasing the bank's duties beyond its original contract. Nowhere in the original contract had it exacted of the bank a "*verification*" of the accounts of the teller. "Verification," as now contended for, means such an examination and comparison, inspection and scrutiny of the books and accounts of the teller as would detect any embezzlements, however cunningly contrived or hidden upon the face of the books. If these companies will make it apparent or visible upon the face of the contract what is now and here contended for, they will quit the field of competition for business and patronage quite soon.

The condition of the original contract, and of each renewal was: "That there shall be an *inspection* or *audit* of the accounts or books of the employe, on the behalf of the employer, at least once in every twelve months from the date of this bond." (Rec. 11.) This is what the bank agreed to do, and this is what it understood it was certifying it had done. It is argued here as if the bank had made a contract for such effective and absolute supervision as would detect and prevent abstractions of its funds, and

in this circular solemnly certified that it had done so, and the bond was renewed on the faith of this statement, as if it was a guaranty on the part of the bank that the past was forever closed, and that the bank had somehow estopped itself from looking into past embezzlements, and that it would be a fraud on its part to insist thereafter there were or had been embezzlements.

The court will observe that the very words of the contract put the only limitation upon retro-examination and discoveries in this language: "Committed by him and discovered during the continuance of this bond, and within six months from the employe ceasing to be in said service" (Rec. 10), showing thereby that back inspection of the books of the employe were intended, notwithstanding a renewal in the meantime. The effect of the contention of our opponents, in view of all the facts, is this: The bank agreed to make an "inspection or audit" once in every twelve months, and then at the end of the twelve months, to make the bank say that it had "examined and verified."

## V.

## ASSIGNMENT OF ERROR ON TELLER'S BOND.

The first assignment is made on the agreement of the bank to notify the company on becoming aware of the employe *being* engaged in speculation, and it is claimed that the bank learned that the employe had not only been speculating, but had been a part owner in a gambling con-

cern, and neither investigated the matter on its own account nor notified the company.

This assignment is based upon a condition in the bond, as follows:

"That the *employer* shall at once notify the company on his becoming aware of the said employe *being engaged* in speculation or gambling, or indulging in any disreputable or unlawful habits or pursuits." (Rec. 11.)

The proof on this is that Eatherly, a director in the bank, saw an anonymous letter addressed to Woodard, in which it was stated that "Schardt was a partner in a bucket shop." He showed the letter to Schardt, who said, "It is a lie, and I can prove it," and went out and returned with Searight and Barry, saying, "Here are the men who can tell you whether that is true or not." It resulted in this: Searight said: "Some time before that Schardt, Barry, and he had agreed to open a brokerage association. Each one was to put in $200. Schardt, in a short time, became dissatisfied, and sold his interest to Searight at a small loss." This anonymous letter was just prior to the resignation of Judge Woodard. Woodard's resignation bears date of February 17, 1893, and was accepted March 25, 1893.

So it is doubtful, so far as this witness is concerned, whether any of this matter relates to the time the teller's bond was in force.

This proves that he took stock in a brokerage association to the amount of $200, and sold out at a small loss in a short time.

A brokerage association neither buys or sells for itself, and is but the broker or agent of others, engaged in speculation on the boards of other cities.

I have cited in appendix hereto the various acts of the Legislature of Tennessee, from the act of March 30, 1883, to April 30, 1893, showing that dealing in futures, "whether actual delivery is intended or not," was a privilege and licensed during this time by the State, and was not gambling or gaming, or in any sense unlawful, and the Supreme Court so held, in *State* v. *Duncan*, 16 Lea, 79, 80.

To prove that a man was a stockholder in a brokerage association does not necessarily prove that he was speculating or gambling or indulging in any disreputable or unlawful habits.

"Purchase and sales of stocks by an officer in a bank is not ipso facto evidence of dishonesty, but if such officer be engaged in stock gambling, or buying and selling beyond his means, he should not be continued in a place of trust."

Scott v. National Bank, 72 Pa. St., 471.

The other witness called to prove that Schardt speculated, was Sykes, the cashier, and acted as such during the year 1892, *and who recommended Schardt as his successor*, and who had litigation with the bank at the time his deposition was taken, arising out of his conduct as cashier. He testified that a man named Kyle, who represented Myers & Co., of New York, told him in the summer or fall of 1892, that Schardt was a part owner in a brokerage association, and that he told Schardt what Kyle had told him, and that Schardt admitted that "he, at one

time, had been interested in such a concern but had sold his interest." Sykes also testified that Schardt told him that "he had speculated to some extent, but made money." He also refers to the anonymous letter. Says he thinks he told Baxter, the President, of these things.

Do the foregoing constitute "becoming aware?" The word "aware" is not used here in the sense of "heard," as in the cashier's bond. "Aware" is universally defined as "possessing knowledge," "conscious," "cognizant," "informed through the senses," and is a synonym of "certain," "certified," "sure."

This court held that a provision like the foregoing, "requiring written notice to the obligor of any act of the cashier involving loss to the bank, to be given as soon as practicable after the bank had knowledge of such act, does not require notice upon suspicion, but only after the bank has knowledge of such *facts* as would justify the charge of fraud and dishonesty against the cashier."

American Surety Co. v. Pauly. 170 U. S., 131 (42 L. C. P. Co., 977).

"*Being* engaged in speculation or gambling or indulging in any disreputable or unlawful habits or pursuits," certainly implies some continuing and substantial manner, either as to *time* of its continuance, or magnitude of the transactions, not to one or two, or even more times, in the past.

"*Being engaged*," is not the same as having been engaged. The one is present tense, the other a past fact when first heard of. "Being engaged in speculation or gambling or indulging in any disreputable habits or pur-

suits," are all words of the present tense. Had it been the mind of the company to have refused its insurance to one who had ever been guilty, at any past period of his life, of any of these things, it could have said so plainly. Not a single transaction of gaming is shown, not the loss of a dollar. It does seem, if he did lose so large an amount, either in Nashville or New York or elsewhere, some one loss or speculation could have been shown. I concede that it is a probable inference, but is not a proven fact; and had the bank dismissed him for any of these causes, if sued for slander, it could not have defended itself against damages, or if it had written the company that he was doing any of these things, it would have been a libelous charge, which it could not justify or have found legal excuse for.

It is quite clear that the bank was not obligated under this contract, or independently of it, to ransack Schardt's past life, or to run down rumors and suspicions and report them to the Guarantee Company. The company had its agent at Nashville to do this character of work.

State v. Atherton, 40 Mo., 207 11 (C. C. A.).

The insistence of the Guarantee Company is that "becoming aware," is synonymous with "having heard," "rumor," "suspicions," and "being engaged," means in this contract "having been engaged," in the indefinite past.

There is no doubt that Schardt took a very large amount of money from this bank, but that he ever had what is commonly known as a gambling transaction, or that he

ever indulged in any disreputable or unlawful habits, or lost a dollar in speculation, has not been shown in this record. It is to-day a surmise what he did with it, and *not a fact*, but an inference, that he lost it in speculations somewhere and at some time. His dying declarations furnished the best evidence of how he lost it, and these came too late for the defendant to successfully use them in this case.

## VI.

The next error assigned is:

*The bank procured the teller's bond to be renewed in January, 1892, by representing that the employe's books and accounts had been examined and verified, when the books showed a default of $23,365.14 in a bank with a capital of only $50,000.*

I have disposed of this assignment heretofore. See page 18 to page 23, so far as it relates to the words "examined and verified," and what is not heretofore disposed of will be discussed with the next assignment.

## VII.

The third assignment is:

*The bank agreed to observe, or cause to be observed, all due and customary supervision over the said employe for the*

*prevention of default, and during the currency of the bond, ceased to compare ledger balances, or correctly count the notes held by the bank, which was not only customary with other banks, but was customary in this bank up to the time this shortage commenced.*

**This assignment is based upon the following condition of the bond:**

**"That the employer shall observe, or cause to be observed, all due and customary supervision over the said employe for the prevention of defaults, and if the employer shall, at any time during the currency of this bond, condone any act or default on the part of the employe, which would give the employer the right to claim hereunder, and shall continue the employe in his service, without notification to the company, the said company will not be responsible hereunder for any default which may occur subsequent to said act or default of said employe so condoned."**

This is another very broad and indefinite expression, an is reasonably susceptible of several interpretations. It is contended on the part of the Guarantee Company that it has but one meaning, and this is, that it relates to the *books* and *accounts* kept by the employe, and is a covenant on the part of the bank that it will keep the same character of books, and keep them in the same manner as is customary with other banks, and thereupon, it proceeds to show that it had been the custom of this bank, up to 1890, to compare ledger balances and take off trial balances as often as every thirty days, and thereafter it ceased, and, in this connection, it says that this custom universally prevailed in other banks, and it concludes by

insisting that this failure, in this particular, avoids the bond, because it was a failure "to observe all due and customary supervision of the said employe to prevent defaults." If this condition be taken, literally, it has no reference to the books of the bank. The words are "due and customary supervision over the employe." It does not say over the books kept by him, or over the work done by him, but over him personally, as respects his habits, association, as well as his prompt and daily presence at the usual and customary hours. The balance of the sentence is consistent with this view, and is inconsistent with the contention of the Guarantee Company, in that it relates to condonements and *personal* matters as distinguished from books and methods of bookkeeping.

Again, the company had made inquiry and been told all it desired to know in respect to the books, *i. e.*, when inspected, by whom inspected, and had put its ultimatum to the effect that they should be *inspected* at least once in every twelve months. It made no objection to what had been told it. It prescribed no methods of bookkeeping. It did not prescribe the extent and vigilance of the prescribed supervision, how it should be done, and what would be expected or required. Besides, the Guarantee Company had been told, in the application or declaration, that there would be an "inspection or audit" of the books and accounts of this employe once in every three months, and that it would be made by the finance committee. The only limitation upon the liability of the Guarantee Company should be found in the clear and unambiguous language of its contract. Indemnity was the purpose of the

contract, indemnity was what the premium was paid for, and there should be no inference against indemnity.

In the case of an ordinary surety upon the bond of an officer of a bank, it has been held "that negligence of the officers of a bank, in failing to examine the books and to discover the defalcations of the paying teller, does not release the sureties on his bond, given for the faithful performance of his duties."

Lieberman v. First National Bank, 40 Atl., 382.
Bank v. Root, 2 Metc. (Mass.), 540, by Shaw, C. J.
Taply v. Martin, 116 Mass., 275.
Bank v. Stephens, 39 Me., 532.
Farmington v. Stanley, 60 Me., 472.
Wayne v. Bank, 52 Pa. St., 343.
Phillips v. Bossard, 35 Fed. Rep., 100.
Sparks v. Bank, 3 Del. Ch., 302.

*Graves* v. *Bank*, 10 Bush (Ky.), 23, has been overruled in every case in which it has been discussed, and stands alone and unsupported.

Lieberman v. First National Bank, 40 Atl., 386.
Bank v. Albee, 63 N. H., 161.

The company undertook, for the honesty and fidelity of Schardt, absolutely and at all events, and engaged to make good his defaults. The rule is, "It is good faith and not diligence which is required of the creditor as a condition of his right to hold the surety, but the creditor or obligee on a bond is not obliged, for the benefit of the surety, to watch the principal beyond what he literally contracted to do." These sureties would become worthless if due diligence is to be required of directors of a bank. Chief Justice Shaw tersely says (2 Met., 540,) *supra*, "Negli-

gence of directors and their agents is no excuse," and *Judge Thompson (in 52 Pa., 349)*, says:

"I know of no positive duty resting on the officers of a bank to investigate with a view to inform a surety, in the absence of a request, to do so. Neither the bank or its officers knew or had reason to suspect the defalcations discovered."

Even the case of *Graves* v. *Lebanon National Bank*, 10 Bush, 28 (19 Am. Rep., 50), holds:

"The directors may have been negligent in the discharge of their duties, and this negligence may have enabled Mitchell for the time to misappropriate the funds of the bank and conceal its true condition by the false reports made to the Comptroller of the Currency, and by false entries upon the books of the association, but this cannot avail the sureties, who covenanted that their principal should well and truly perform the duties of his position. Their covenant is unconditional, and no failure of duty on the part of directors of the association short of actual fraud or bad faith can be deemed sufficient to exonerate them from its performance."

In the case of *McShane* v. *Howard Bank*, reported in 10 Law. Rep., Anno., 552, is a decision of the Supreme Court of Maryland, and covers several points presented by our adversaries, and holds:

"Acts of bank directors in aiding the executive officers to conceal defalcations and embezzlements of the bank's funds are void."

If, then, active aid given to the cashier in his frauds could not release the sureties of the cashier, it is difficult to see how their negligence could do so, if they were negligent. On this proposition the court held:

"The directors owe a duty of fidelity to the stockholders, and their breach of that duty, by participating in the malversations of executive officers, or by aiding the latter in their attempts at concealment, differs nothing in principle from a case where the directors deliberately authorize a cashier to plunder the funds of the bank or to cheat the stockholders of their interest therein."

The court then repeats the words of this court, in the case of *Minor* v. *Mechanics' Bank*, 1 Pet., 70 (7 L. Ed., 57,) as follows:

"Every act of fraud, every known departure from duty, by the board of directors, in connivance with the cashier, for the plain purpose of sacrificing the interests of the stockholders, though less reprehensible in morals, or less pernicious in its effects than the case supposed, would still be an excess of power for its illegality, and as such void as an authority to protect the cashier on his wrongful compliance."

2. The court further held:

"A creditor is under no obligation to be actively diligent in pursuit of his principal debtor. He may forbear to prosecute his claim and remain inactive without impairing his right to resort to the surety, particularly when his forbearance amounts to no more than mere inaction or passivity." Citing *Gasslor* v. *Young*, 6 Gill & J., 243; *Freaner* v. *Zingling*, 37 Md., 491.

3. "If the creditor is not bound to active diligence, his mere failure to voluntarily give information to the surety of the default of the principal cannot have the effect of discharging the surety." Citing *Forrester* v. *State*, 4 Md., 154; *Pittsburg, Ft. W. & C. R. R. Co.* v. *Shaeffer*, 59 Pa., 356.

4. The court also held:

"It is a sound principle that the failure of one officer of a corporation to discharge his duty does not release the

sureties of another from responsibility for the defaults of the latter. Corporations can act only by officers and agents. They do not guarantee to the sureties of one officer the fidelity of others. The fact that there were other unfaithful officers and agents of the corporation who knew or connived at his infidelity ought not in reason, and does not in law or equity, relieve them from their responsibility for him. They undertake that he shall be honest, though all around him be rouges. Were the rule different, by a conspiracy between the officers of a bank or other moneyed institution, all their sureties might be discharged. It is impossible that a doctrine leading to such consequences can be sound." Citing *Pittsburg Ft. W. & C. R. R. Co.* v. *Shaeffer*, 59 Pa., 356; *Taylor* v. *Bank of Ky.*, 2 J. J. Marsh., 565; *United States* v. *Kirkpatrick*, 22 U. S.; 9 Wheat., 720 (6 L. Ed., 199).

The court further held:

"That if the bank, with knowledge of its officer's default, retained him and paid him salary, or failed to hold to money or securities in its possession and apply them to his debt, will not discharge the surety for antecedent liability." Citing 59 Pa., 356.

"No act or vote of a board of directors in violation of their own duties, and in fraud of the rights and interest of the stockholders of a bank, amounts to a justification of a cashier (or other officer) who was *particeps criminis*."

Minor v. Mechanics' Bank, 1 Peters. 71.

This holding is affirmed in the following cases:

National Bank v. Drake. 29 Kan., 328.
McShane v. Howard Bank, 73 Md., 150 (20 Atl., 779; 10 L. R. A., 556.)
Frelinghuysen v. Baldwin. 16 Fed. Rep., 453.
Phillips v. Bossard, 35 Fed. Rep., 100.

All holding that the cashier or his sureties are not released from liability because of the negligence or misconduct of the president or of board of directors.

Amherst Bank v. Root. 2 Met., 541.

Holding sureties were not exonerated because of the neglect of the directors to examine into the affairs of the bank.

Farmers' Bank v. Sparks, 3 Del. Chan., 303.

Holding that the neglect of directors to supervise the accounts does not discharge the sureties. This applies to sureties of teller.

State v. Atherton, 40 Mo., 217.

To sureties of bookkeeper.

Chew v. Ellingwood, 86 Mo., 272: 56 Am. Rep. 434.

To sureties of bookkeeper.

Frankfort Bank v. Johnson, 24 Me., 504:
Tapley v. Martin, 116 Mass., 278.

Where a cashier committed frauds unknown to the directors, although they were guilty of gross negligence.

Lieberman v. First National Bank, 40 Atl., 384.

Holding sureties of cashier not discharged by failure of directors to examine his books.

United States v. Cutler, 2 Curtis, 625:
Fed. Cases, 14, 911.

Holding surety not discharged because of the failure of the government agents to discharge their duty.

United States v. Robertson, 5 Peters, 666.

Holding that every illegal act of the officers of a bank, although sanctioned by usage, is void.

Minor v. Mechanics' Bank, 1 Pet.

## VIII.

## FOURTH ERROR ASSIGNED ON TELLER'S BOND.

*The bond provided that there should be an inspection or audit of the accounts and books of the employe, on behalf of the employer, at least once every twelve months. Yet the ledger balances were not compared, and the notes in the bank were not counted or compared with the amount called for by the books.*

Rec. 14.

This assignment is based upon the following condition of the teller's bond:

"That there shall be an inspection or audit of the accounts or books of the employe, on behalf of the employer, at least once in every twelve months from the date of this bond."

This assignment is not well taken in point of fact—that there was an inspection or audit, as the bank officers understood these words, every three months, and also twice a year, additionally, there can be no doubt.

The real point of this complaint is that these examinations made by finance committee into the condition of the bank, were too superficial to meet the requirements of the bond. It is claimed and insisted that they did not amount to either an "inspection or audit," as these words are understood in the bond, and in proof of this we are referred to the fact that original entries on the books were fraudulent; that the books were full of false additions and other

frauds which a more expert and scrutinizing inspection might and would have detected. Since the experts have taken charge of the books of the bank and called in all pass books from the hands of depositors, and spent several months exploring original entries, uncovering those which were false, pointing out the false additions made in long columns of figures, and shown failures to enter upon the books moneys collected, and how, after making a false entry on one book, he would falsify entries on other books in order to make them correspond as a whole, it is quite easy now to see how these frauds might have been detected by the committee, and how apparently negligent the finance committee must have been not to have discovered them. It is not the business or duty of directors to go back to original entries.

Briggs v. Spaulding, 141 U. S., 132.

Ex post facto wisdom enlarges and sharpens our retrospective vision, so that, in every backward glance we see things lying near to us upon the very surface, the existence of which we never suspected.

The argument of our opponents is that the books of the bank had hidden under their surface every fact now brought to light, which were as open to the discovery of the finance committee as to the experts, and had the committee made a sufficiently rigid and close scrutiny, they, too, could have made the discovery; *ergo*, the bank did not make the contemplated inspection or audit. "This," said the Court of Appeals, "is substantially construing the contract as a guaranty to the defendant company against

the bank's carelessness in making the examination," and I might add, as guaranteeing to the company that each inspection or audit closed the matter forever to that date.

Insurance is taken to secure the insured against his own negligence or inexpertness, as well as that of his agents and servants. It is nowhere contracted that these inspections or audits, wherever made, should be infallible. If so, there would be little necessity for insurance.

It is said that it contributed to the teller's opportunities to embezzle successfully and avoid detection, by allowing him to discontinue, in 1890, the trial balance book. I do not understand, if original entries were false in one book, and all the other books were made to conform to this, how a trial balance taken from these false entries would have detected anything. The company undertook to guarantee to the bank Schardt's honesty and fidelity to his trust, and especially, that he would not embezzle the funds of the bank, even should he have an opportunity to do so. It seems now probable that Schardt dropped the use of the trial balance book as a part of his scheme to embezzle the funds of the bank, or because of the additional labor it would require to make it conform to the others. At all events, the honesty and fidelity of Schardt was the fact insured; not honesty so hedged about that he could not be dishonest; not honesty compelled and *enforced* by active and sleepless vigilance; not a species of honesty or fidelity secured by an impending threat that an expert bookkeeper would supervise his books, at a greater expense to the bank than the premium paid annually for this insurance.

It is universally known that there are two modes of

inspecting the condition of a bank. The one is that made by the committee of the bank, which never goes to original entries, never adds up columns or calls in pass books, but accepts as correct reports made to it by the cashier, purporting to be taken from original entries. The other is made by expert bookkeepers, who do go to original entries, who make comparisons of the entries made in various books, and which should bear upon each other, which add up columns. The latter, too, calls in all pass books of depositors, and compares entries made in them with corresponding entries upon the individual ledger.

The representations made in the application in this case disclosed to the Guarantee Company that inspections had always been made by the finance committee, and this would be the custom in the future. And no objection was made. It is fair to infer that the Guarantee Company knew that the committees, especially the finance committee, which had charge of supervision and discounts, was made up of the largest stockholders, or persons largely interested in finances and success of the bank, and were willing to leave to it to make such inspections as their interest would dictate. The Circuit Judge, Clark, held on this point that "so long as the bank officers and the committee acted in good faith, such examinations as the appointed committee thought proper and sufficient for the protection of the bank and its stockholders, would satisfy the requirements of this contract. If anything more was wanted, it was a matter for specific agreement."

The principle announced in *American Surety Co.* v. *Pauly*, 170 U. S., 160, that "when a contract is so drawn

as to leave room for two constructions of its provisions, it must be interpreted most strongly against the party who prepared it, and delivered to the other party for his protection."

## IX.

## IN THE MATTER OF THE CASHIER'S BOND.

The cashier's bond constituted Exhibit A to the original bill, and is set out from pages 5 to 9 of transcript—is in the penal sum of $20,000, and is dated January 1, 1893. The annual premium of $100 was paid. This premium carried the bond to January 1, 1894.

This bond was only in existence from January 1, 1893, to April 17, 1893, when Schardt died.

The amount claimed upon this bond is $22,964.17 of principal, and $164.52 interest, aggregating $23,128.69.

Rec., 28.

This sum was taken between January 16, 1893, to death of Schardt, in April following.

The bond recites that:

"Whereas, the said employe has been appointed cashier at Nashville, Tenn., in the service of said employer, and has been required to furnish security that he shall not be guilty of any *fraudulent* act in the performance of his duties in said capacity, by which the said employer shall suffer any pecuniary loss."

Later, by recitation, the bond undertakes to limit the liability of the Guarantee Company, "to any act of fraud committed by the said employe in connection with the du-

ties of said appointment, and constituting embezzlement or larceny."

This bond contains, also, the following:

"Said company, fully relying on the truth of the statement and declaration contained in a certain document distinguished as employer's guarantee proposal No. 154,806, dated the 10th of January, 1893, and signed, Lewis T. Baxter, President, on behalf of said employer, and lodged with the said company at its office in Montreal, and in the strict performance and observance hereafter by the said employer of the contract thereby created, do hereby," etc.

Said bond also contains the following:

"Provided, always, that this bond and guarantee, hereby granted or undertaken, shall be subject and liable to the terms and conditions hereupon indorsed."

I shall notice only such terms and conditions as are supposed to be material to this lawsuit, and omit all others:

"1. Any misstatement of a material fact in the declaration within mentioned, or in any claim made under the bond, will render the bond void from the beginning.

"2. That said employer shall use all due and customary diligence in the supervision of said employe for the prevention of a default, and to that end shall cause an inspection or audit of his accounts to be made at least once in twelve months, and if the said employer shall, at any time during the currency of this bond, become aware of any act or default on the part of such employe, which would constitute a claim hereunder, and shall continue said employe in his service, without notification to the said company, the said company will not be responsible hereunder for any loss or default which may occur subsequent to said act or default of said employe.

"3. That any written answers or statements made by, or on behalf of said employer in regard to, or in connection with the conduct, duties, accounts, or methods of su-

pervision of the said employe, delivered to the company either prior to the issue of this bond, or any renewal thereof, or at any time during its currency, shall be held to be a warranty thereof, and form a basis of this guarantee, or of its continuance.

"4. That the said employe has not, to the *knowledge* of said employer, been guilty of any serious dereliction of duty or default in this, or any other service, or that his habits have been such as to incur said employer's censure previous to the issue of this bond.

"6. This bond shall extend to cover only such losses as may have been incurred by reason of the *fraud* of the said employe during the currency of this bond, and within twelve months previous to the notification to said company of any default hereunder."

The cashier's bond was issued upon what is called employer's guarantee proposal No. 154,806, and which is signed by Lewis T. Baxter. I now quote from this all the questions and answers supposed to be material to this suit, omitting all immaterial.

Rec. 89, 90.

"Ques. 3. Has he ever been in arrears or default in the bank's service, or, as far as you have heard, in any previous employment?

"Ans. No.

"Ques. 4. Have you known or heard of anything unfavorable as to his habits or associations, past or present, or of any matters concerning him about which you deem it advisable for the company to make inquiry?

"Ans. No.

"Ques. 13. When were applicant's books and accounts, including cash, securities, and vouchers (if any) last examined, and by whom?

"Ans. December 31, 1892, by finance committee (where they found correct), of bank, and found correct.

"Ques. 14. In case of applicant's handling cash or securities, how often will the same be examined and com-

pared with the books, accounts, and vouchers, and by whom?

"Ans. Not less than quarterly, and often monthly, by finance committee?

"Ques. 16. Will applicant handle funds or securities not subject to routine check or periodical examinations? If so, please describe their nature.

"Ans. No."

All the above and many other questions and answers are concluded by this general printed language:

"The above answers and representations are true to the best of my knowledge and belief." Dated January 10, 1893. Signed: "Lewis T. Baxter. Official title, President."

The assignments of error made in this court in respect to this bond are set out on page 14 of brief of defendant in error (omitting many set out in the record before the Court of Appeals but not renewed in this court), and are as follows:

1. The bank represented that it did not know of and had not heard of anything unfavorable as to his habits or associations, past or present, of the employe upon whom it was seeking the issuance of the bond, yet, at the time the bank and the particular officer making the statement for the bank, *knew* that the employe had been engaged in speculation, and had been a partner in a gambling concern while occupying a position of trust in the bank, and no effort was made to verify his statement that he had sold out his interest in the bucket shop and had ceased speculating.

2. The bank procured the issuance of the cashier's bond by representing that the books and accounts of the employe, who had been its teller for five years, had been examined and found correct to the end of his term of office; yet, at that time, the books and accounts of the bank showed a default of $73,715.44, in a bank with a capital of only $50,000.

3. The court allowed $5,992.12 of overdrafts "allowed but not authorized," as a part of the default for which the company was liable, although the bond only protected the bank against a default "constituting embezzlement or larceny."

The court perceives that this bond makes an effort to create a *warranty* in respects of all written statements or answers made by Baxter, "in regard to or in connection with the conduct, duties, accounts, or methods of supervision of said employe prior to the issue of this bond."

The superadded words that the facts are true "to the best of insured's knowledge," imply a wilful untruth to avoid the policy.

1 Biddle on Ins., sec. 562, citing
Clapp v. Mass. Benef. Asso'n, 146 Mass., 519.
United Breth., etc., v. Kinter, citing France v. Ætna Ins. Co., 94 U. S., 561; Ins. Co. v. Grivly, 100 U. S., 614, and other cases.
National Bank v. Ins. Co., 95 U. S., 673.

Applying the principles of law to the facts, we have this:

To the question:

"Has he ever been in arrears or default in the bank's service, or as far as you have heard in any previous employment?"

The answer is:

"No, to the best of my knowledge and belief."

So, with reference to the fourth question, whether he had known or heard anything unfavorable as to his "habits or associations, or any matters concerning him about which you deem it advisable for the company to make inquiry?"

The answer is:

"No, to the best of my knowledge and belief," and so on, as respects the other questions, viz.: 13th and 16th.

The proof abundantly shows that Schardt's habits and associations, as far as the community knew, were good, and that he was esteemed a model man.

Suppose Baxter had heard through an anonymous letter that Schardt had, at one time, owned stock in a brokerage association, or that he had one or more transactions in speculation. These cannot be said to constitute habits or create "associations."

Ætna Ins. Co. v. Davey, 123 U. S., 739.
3 Joyce on Ins., sec. 2076.

Bearing on this point, we must look to that condition of the bond relating to this same matter, and read it in connection with the questions and answers as quoted above. It reads: "That the said employe has not, to the knowledge or belief of said employer, been guilty of any serious dereliction of duty or default in this or any other service, or that his habits have been such as to incur employer's censure previous to the issue of this bond."

The question called for Baxter's personal "knowledge and belief." He had no *knowledge* is certain, and he said that he had no belief, "which he deemed it advisable for the company to make inquiry about." The argument is that he should, in view of the statements of the anonymous letter and what Sykes says he told him, have a belief, and that the court should hold that he did have a belief. The Guarantee Company selected Baxter as the person to answer the questions, and sought his personal belief, as they

might have selected the sheriff, or any other public man, to give it the benefit of his knowledge and belief. The correspondence is addressed to "Lewis T. Baxter, pt.. managing director Mechanics Savings Bank and Trust Co., Nashville, Tenn.," and requested such information as "*you* deem it advisable." The argument of our opponents goes upon the theory, that, by reason of all this, Baxter became, in some way, a detective for the Guarantee Company, and that it was his or the bank's duty to run down to a positive affirmation or denial, every loose rumor in respect to their employe, no matter how ignoble the source and vehicle of the information.

Representations, expectations, belief, or opinion, without fraud, do not avoid a policy.

2 Joyce on Ins., secs. 1903. 1904. and cases cited.
Beham v. United Guarantee Co., 7 Exch., 744.
21 L. J. Ex., 317.

## X.

The next assignment of error on the bond of the cashier is quite a broad statement of the facts. It is:

"The bank procured the issuance of the cashier's bond by representing that the books and accounts of the employe, who had been its teller for five years, had been examined and found correct to the end of his term of office; yet, at that time the books and accounts of the bank showed a default of $73,715.44, in a bank with a capital of only $50,000."

All the foregoing is based upon question 13 and answer thereto, propounded to Baxter by the Guarantee Company, under the circumstances and qualifications stated hereinbefore:

"When was applicant's books and accounts, including cash, securities, and vouchers (if any) last examined, and by whom?

"Ans. December 31, 1892, by finance committee (where they found correct) of bank and found correct."

Rec., 90.

This answer was given under the qualification, "to the best of my knowledge and belief." The proof abundantly shows that the books and accounts had been examined December 31, 1892, by the finance committee, and found and reported correct by that committee. This complaint is directed—not to the fact, but to the mode and thoroughness of that examination. This we have presented heretofore, on the same question made in respect to the teller's bond, and to which we refer the court.

## XI.

## $5,992.35 OF OVERDRAFTS.

It is said that this item should not be allowed as a charge against the Guarantee Company, on the bond of the cashier. Solicitors for the company say: "This may have constituted a fraudulent act of the employe (Schardt), but it certainly cannot be either embezzlement or larceny."

We have several replies to this:

The Court of Appeals, on the last trial, disallowed the items constituting the $5,992.35, but otherwise affirmed the judgment of the Circuit Court, the Court of Appeals holding that there was no sufficient evidence that this sum was taken by Schardt, under such circumstances as

constituted either embezzlement or larceny. To this complainant filed the following exceptions upon the record:

THE GUARANTEE COMPANY OF NORTH AMERICA *v.* THE MECHANICS' SAVINGS BANK AND TRUST COMPANY.

For the use of J. J. Pryor, Assignee.

The plaintiff, the Mechanics' Savings Bank and Trust Company, by its attorney, Edward H. East, comes on this the nineteenth day of January, 1901, and assigns error, and says that on the record and proceedings in the above entitled cause there is error in this, to wit:

I.

The Court of Appeals for the Sixth Circuit committed error in allowing the defendant credit for $5,992.35, on his bond as cashier, the proof showing that this sum was a part of his defalcation, under the terms of said bond.

II.

The court erred in not finding and holding from the proof, and upon a full construction of the bond, that the default of Schardt, accomplished by embezzlements, under the bond as cashier, was $22,964.17, committed during the currency of said bond, viz.: between January 1, 1893, and April 17, 1893.

EDWARD H. EAST,

*Solicitor for Complainant.*

First. Every item of embezzlement and larceny making up the large sum reported by the experts, was set out in what is known in the record as Exhibit X to the bill, and was a part thereof. Said Exhibit X only purports to show the *embezzlements and larcenies* of the cashier and teller. It makes no effort to exhibit any item that had been honestly dealt with, as shown by the books. Said exhibit occupies about six pages of closely printed figures in the record. (See Rec., pages 13 to 18, inclusive), and includes probably a little less than eight hundred items of money, varying in amounts. It took the experts some seven months to go through the books of the bank and cull out these dishonest items from the great mass of honest transactions.

An inspection of the exhibit shows that the experts set out the date of the dishonest transaction, the amount thereof, how it was accomplished; in brief, citing the book and page where and on which the item could be found. This exhibit was made a part of the bill. I will state just here that the Guarantee Company had been asked to put in an expert bookkeeper to assist in making out the exhibit, and declined to do so. Also the widow and administrator of Schardt had been likewise requested, and had done so.

This Exhibit X shows the default of Schardt, as cashier, to be $22,817.30, of which said item of $5,992.35 constituted a part. This Exhibit X constituted the proof of loss made to the Guarantee Company.

The following is the language of the bill:

"Complainant now charges that said Schardt, as such cashier, and during the currency of said bond, did, as

shown by the report of said expert accountants and bookkeepers, and did, in fact, by acts of fraud committed by him in connection with the duties of his said office, and constituting embezzlement or larceny, take of said bank and appropriate to his own use, the sum of $22,817.30, without interest, and for which complainant is entitled to reimbursement under the terms and conditions of said bond."

The bill then proceeds to state that it did give notice, "and make the proof of the facts to said Guarantee Company."

While this Exhibit X was filed in court as a part of the bill, and a copy thereof in the hands of the Guarantee Company, and its solicitors, it filed its answer, stating as follows:

"Respondent admits that after said bank made its assignment to said Pryor, its affairs were examined, and it was discovered that said Schardt had *abstracted* from said bank a large amount of its money, a part of which was *abstracted* in the year 1890, a part in 1891, part in 1892, and a part in 1893, but the respondent does not admit that the amounts *embezzled* in each year are correctly stated in the bill," thus showing that defendant knew that every item of Exhibit X was charged as embezzlement.

The answer does not raise any issue on any item in said exhibit, or make the point now made, that the taking did not amount to an *embezzlement* or *larceny*. With the exhibit before defendant, the question should have been raised either in the answer, or certainly in the examination of witnesses, who testified to the correctness of the items in said exhibit, as embezzlement or larcenies.

It is evident to the court that exhibit X was the basis for the examination of the expert witnesses, and that it was not necessary to ask these witnesses if Shardt had embezzled or stolen such items *eo nomine*. The witnesses, the parties, and the attorneys went upon the theory that this exhibit contained the entire claim of complainant, and that each item was embezzlement or larceny. The experts headed the exhibit with these words: "Statement of shortage of John Schardt, cashier and teller of the Mechanics' Savings Bank & Trust Co."

The examination of the witnesses who made this exhibit, both original and cross, proceed upon the theory that "shortage" meant embezzlement or larcenies. Sometimes the word "defaulter" is used. I give samples of the original and cross-examination:

Ques. 4, of McEwin. Witness was asked with reference to each and every one of the several hundred items of said exhibit: "Please state what was the character of these defaults, and of what did they consist as respects detention?

"Ans. They were extractions from the funds of the bank, made by Schardt, and were evidenced by the books kept by him, and covered on the books kept by him from detection.

"Ques. 5. Please state whether these abstractions or embezzlements were easily or readily detectible? etc.

"Ques. 7. How long were the bookkeepers and you engaged in ascertaining these abstractions?

"Ques. 9. In order to ascertain the facts of embezzlement of the funds of the bank? etc.

"Ques. 12. Please state whether the amounts, as stated above by you, were taken from the funds of the bank?

"Ans. These amounts mentioned were abstracted by John Schardt, etc."

On the cross-examination of this witness, the attorney for the company, Mr. Granbery, proceeding upon the idea that every item in Exhibit X was an embezzlement or larceny:

"Cross question 15. Please furnish statement marked Exhibit 4, showing in detail the amount embezzled in each particular year, and each method."

The witness did so. It is alone in this Exhibit 4 that the aggregate of embezzlements, viz.: $5,992.35, done by means of overdrafts, first appears.

Rec p. 39

In Exhibit X each item of embezzlement is set out, but this does not, in every instance, show how it was done. Our friends on the other side wanted an exhibit showing, in brief, the amounts embezzled in each particular year, and the method by which each was accomplished. In this he was accommodated, said exhibits showing the amount of embezzlements each year, and the method by which it was done, such as "failure to credit deposit," "manipulating individual deposit," "failure to credit notes collected," "failure to enter deposit," etc., and then the items of $5,992.35, and the method by which it was done is stated to be "overdrafts allowed and not authorized." Our opponent's question called for embezzlement, and the method by which it was accomplished. Now he seizes upon the method set out in the answer to show that it was not an embezzlement, but was money obtained in some mode discreditable, or otherwise, not amounting to an embezzlement.

I refer the court to the questions and answers of Professor Jennings, who helped make out Exhibit X, and who, in response to the question, what was the result of the examination, said:

"I examined the books from September 9, 1890, to April, 1893, finding John Schardt's shortage during that time as teller and cashier, including interest, to be $107,182.12." He then sets out the amount for each year, and adds: "As cashier from January 1, 1893, to April 17, 1893, $22,964.17, and this item of $5,992.35 is included to make that sum."

Jennings stated the shortage of Schardt, as cashier, to be $22,964.17. He was then asked question 4:

"From whom had the money been taken or abstracted?

"Ans. From complainant bank.

"Ques. 5. Was the fact shown by books kept by Schardt, or which were under his care and keeping?

"Ans. Yes.

"Ques. 6. Was it shown to be money taken, or other valuables?

"Ans. As money taken.

"Ques. 7. How was Schardt shown to be connected with the embezzlement?

"Ans. The manipulations on the books were all shown to be in his handwriting."

The record abundantly shows that the whole testimony was taken upon the theory that Exhibit X showed only items of embezzlement or larceny.

On the trial and in the argument before the Circuit Judge (Clark), no such point was made, as the opinion reported in 68 Fed. Rep. shows. After Judge Clark had decided the case, and directed judgment to be entered for

complainant, and the decree was prepared and submitted to the court, on July 1, 1895, the attorney for the company for the first time called the attention of the court to this item, pointing out the present objection by error which he assigned August 1, 1895.

Neither the bill nor the testimony made effort to hold Schardt or the company liable for "overdrafts" as such, but only for embezzlements or larcenies, but if Schardt made an overdraft on the bank in the name and behalf of another party, and without the knowledge of such party, or the bank, and himself took the proceeds and used them, it would be larceny or embezzlement on the part of Schardt, and the fact that it was called an "overdraft" by the experts would not make it a legitimate transaction, or deprive the transaction of its felonious character. Especially would this be true when the experts were asked to state the *amount embezzled*, and the method used by the *embezzler*.

The question concludes the particular criminality as that of embezzlement, and shows that the method by which it was accomplished was by overdraft.

This point was not made before the trial judge, and it was too late to assign it as error in the Court of Appeals or in this court.

Danforth Dig., Vol. I, p. 1047, where all the cases are collected.
Marine Bank v. Fulton, 2 Wall., 252.

It is too late to present the question for the first time on a motion for a new trial.

Reagin v. Aiken, 138 U. S., 110.
Pacific Express Co. v. Malen, 132 U. S., 531.

We insist that under the rules of interpretation governng contracts of this character, that the bank would have the right of recovery for this item of $5,992.35, because of the ambiguity of the bond in its entirety, and that the Guarantee Company cannot insist that the act of fraud must amount to a technical "embezzlement" or "larceny."

The bond declares: "Whereas, the said employe has been appointed cashier at Nashville, Tenn., in the service of said employer, and has been required to furnish security that he shall not be guilty of any fraudulent act in the performance of his duties in the said capacity, by which the said employer shall suffer pecuniary loss; and, whereas," etc. Later, and after many recitations in which the mind of the reader, especially a layman, would have lost the connection, it says, it covenants "to reimburse unto said employer, or his or their representative or assigns, the amount of any loss, not exceeding in the whole the sum of twenty thousand dollars, which, during the currency of this bond, shall be sustained by the said employer by reason of any act of fraud committed by the said employe in connection with the duties of said appointment, and constituting embezzlement or larceny."

The sixth condition provides:

"This bond shall extend to cover only such losses as may have been incurred by reason of the fraud of the said employe during the currency and within twelve months previous to the notification to the said company of any default hereunder."

It is no answer to say, that, while the bond is ambigu-

ous in respect to what acts the Guarantee Company will be liable for, in one place saying, "fraudulent acts, etc., by which the said employer shall suffer pecuniary loss;" at another place saying, "any acts of fraud, etc., constituting embezzlement or larceny," and at another place saying: "This bond shall extend to cover only such loss as may have been incurred by reason of the fraud of the said employe during the currency of this bond, and within twelve months," etc.

It will doubtless be replied to this that the first relates to the scope and obligations which the Guarantee Company is about to assume; that the next insertion relates to what it actually contracts to do, and that the third and last is a condition on the back of the bond relating to a limitation. It will not be denied, however, that the bond as a whole is ambiguous on this point, when read by the public generally, for whom it was intended.

This court has uniformly held:

"If looking at all its provisions, the bond is fairly and reasonably susceptible of two constructions, one favorable to the bank and the other favorable to the surety company, the former, if consistent with the objects for which the bond is given, must be adopted, and for the reason that the instrument which the court is invited to interpret, was drawn by the attorneys, officers, or agents of the surety company."

American Surety Co. v. Pauly, 170 U. S., 133.
Imperial Fire Ins. Co. v. Core, 151 U. S., 452.

This bond more than once professes and pretends to secure the bank against loss by reason of the "fraud" and "fraudulent acts" of the employe, without regard to the technical criminal offense committed, and the public asked

to accept it. The public have little or no concern, and less knowledge, of what constitutes the elements of larceny, embezzlement, or fraudulent breaches of trust, or kindred crimes which go to make up the criminal laws of the country. The public wants indemnity against the wrongful and fraudulent appropriation and taking of money by parties intrusted, necessarily, with its custody and handling, as clerks, officers, etc., and to meet this want these bonds are made, accepted, paid for, and relied upon, and to this end they should be construed, unless there is a clear, unambiguous, and positive interdiction not reached by ingenious construction, but by the necessity of the very words used.

If the one part of the contract contradicts another part, then interpret the whole contract by the general purpose for which the contract has been made and entered into.

The court will notice that both bonds were issued upon printed representations made to the company, and signed in both cases by third persons, who are not parties to this suit, and have no interest herein, viz., Peden and Baxter, and that each of which is a separate and distinct paper from the bond or policy issued. These representations were made in answer to printed questions submitted to them. As respects the bond upon "teller and collector," there is no effort made to make the answers warranties, or the truth of the answer condition precedent to a recovery, the only condition precedent in this bond is "the actual payment of the premium, and its acceptance."

The only other language by which it is undertaken to *unite* the representations with the bond or policy is as follows: "And, whereas, the employe has delivered to the

company a certain statement, and it being agreed and understood that such statement constitutes an essential part of the contract hereinafter expressed." In *Phœnix Ins. Co.* v. *Readdin*, 120 U. S., 1, the policy contained the following: The answer to printed questions was referred to as "the declarations or statements upon the faith of which this policy is issued," and, in the concluding paragraph of the application, the answers are declared to be "fair and true answers to the foregoing questions," and to "form the basis of the contract of insurance." The court held them to be not warranties, but declarations and collateral.

Clearly, the bond or policy issued on the teller and collector contains no warranty by its words or construction.

The other policy or bond on the cashier does make an effort to create a limited warranty in respect to certain things mentioned therein—such as "conduct," "duties," accounts, or methods of supervision—but its fatal defects in these particulars are: (1) It is signed by a third party, Baxter; (2) "on information and belief of Baxter."

Gage v. Lewis, 68 Ill., 604.
Towle v. Society, etc., 3 Gifford, 42.
Benham v. Assurance Co., 7 Welsb. H. & G., 744.

As respect the bond or policy covering the office of cashier, an effort is made to unite the two papers, and also to create a limited warranty, as follows:

"Now, therefore, this bond witnesseth, that the said employe, for and on his own behalf, and the said company, fully relying on the truth of the statement and declaration contained in a certain document, distinguished as employers' guarantee proposal No. 154,806, dated 11th

day of January, 1893, and signed by Lewis T. Baxter, president, on behalf of the said employer, and lodged with the said company at its office in Montreal, and on the strict performance and observance hereafter, by the said employer, of the contract thereby created, do hereby severally and jointly covenant," etc.

"That any written answers or statements made by or on behalf of said employer, in regard to or in connection with the *conduct*, *duties*, *accounts*, or *methods* of supervision employe delivered to the company, either prior to the issue of this bond or any renewal thereof, or at any time during its currency, shall be held to be a warranty thereof, and form a basis of this guarantee or of its continuance."

The most that can be claimed under this is, that the answers, to be warranties, must apply to the *conduct*, *duties*, *accounts*, or *methods of supervision* of said employe. We deny that there has been a breach of said warranty in respect to either. This brings us to the answers of Baxter, in these respects. No one, we insist, is untrue, or constitutes a breach of warranty. It is to be remembered that every answer which Baxter gave was made under these written conditions: "The above answers and representations are true, *to the best of my knowledge and belief*." There can be no warranty when a statement is thus qualified.

There are no questions asked that specifically apply to each of the foregoing.

I submit what question applies to the "*conduct*" of Schardt specifically? It will not be said that the answer was untrue as respects the "duties." His duty was that of *cashier*. What under the head of "accounts?" The only question asked in reference to his accounts, was,

When were his accounts last examined? How often would the cash or securities handled by Schardt be compared with the books, accounts, and vouchers?

No answers were given to questions 5, 15, and 19, and were waived. Question 5 was, whether he was pecuniarily embarrassed or insolvent, or indebted to the bank. Fifteen was, In case of applicant acting as teller will he be required to balance his cash daily and report the same to the president or cashier, and will a record of the same be kept? 19. At what date was the bank last examined by a national or state official, and was the result satisfactory to the department? The answer to these three questions was waived (see *Phœnix Mutual Life* v. *Madden*, 120 U. S. Rep.), and none was made.

It may be said that untrue answers were made to the following questions:

3. Has he ever been in arrears or default in the bank's service, or, as far as you have heard, in any previous employment? The answer was, "No," to the best of my knowledge or belief.

2. Have you *known* or heard anything unfavorable as to his *habits* or *associations*, past or present? Answer, "No," to the best of my knowledge or belief.

These last two questions are indefinitely broad, and might cover anything or nothing by construction. It is clear that neither had reference to any indebtedness of Schardt to the bank, either by previous default as teller or otherwise, for the reason later the company asked specifically about these—and waived the answer. (See question 5.)

In the case of *Fisher* v. *Crescent Ins. Co.*, 33 Fed. Rep., 549, the covenant of the applicant in the application was as follows:

"That the foregoing is a just, true, and full exposition of all the facts and circumstances in regard to the condition, situation, and value of the property to be insured, *so far as same* are known to applicant, and the same is hereby made a *condition* and a *warranty* on the part of insured."

The court held that the words, "*so far as the same are known to the applicant*" reduced or lowered what otherwise would have been a warranty to a representation, which could not be recovered upon in the absence of fraud.

See also,

Wilkins v. Ins. Co., 57 Ia., 539 (10 N. W. Rep., 916).
Redman v. Ins. Co., 47 Wis., 89 (1 N. W. Rep., 363).
Ins. Co. v. Fisher, 30 Fed. Rep., 662.
Bank v. Ins. Co., 95 U. S., 673.
Moulor v. American Ins. Co., 11 U. S., 335.

EDWARD H. EAST,
*Solicitor for Bank.*

# APPENDIX.

VARIOUS ACTS OF THE LEGISLATURE OF TENNESSEE LICENSING DEALINGS IN FUTURES.

ACTS OF 1883, CH. 105, 106, APPROVED MARCH 30, 1883, PP. 103–128.

Dealings in futures was made a privilege. Also by the Act of 1885, Ch. 1, p. 1.

ACTS OF 1887 (pamphlet act), CH. 1, P. 13.

After naming the various and different occupations licensed, it says:

"FUTURES.

"Each person, firm, company, or corporation dealing therein, and each branch or agency of such firm, company, or corporation, per annum, $1,000."

ACTS OF 1889, CH. 130, P. 247.

"FUTURES.

"Dealers in futures, and brokers dealing in futures, whether actual delivery is intended or not, each person, firm, company, or corporation dealing or doing a brokerage association therein, and each branch or agency of such company or corporation, in cities, taxing districts, or towns of thirty thousand inhabitants or over, per annum, $1,000."

This act then grades the amount of the license, according to population, of all towns under thirty thousand.

ACTS OF 1891, CH. 25, P. 50.

This act is the same as the Act of 1889, set out above.

Acts of 1893, Ch. 89, p. 131.

This act is the same as the Act of 1889, Ch. 130, set out above.

There is a proviso to this act to the effect that it shall not be construed to amend, repeal, or modify the criminal laws of the State. Approved April 30, 1893.

These and similar acts of the Legislature were construed by the Supreme Court, in *State* v. *Duncan*, 16 Lea, 79, 80, holding the license valid.

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THE GUARANTEE COMPANY OF NORTH AMERICA

v.

THE MECHANICS' SAVINGS BANK AND TRUST COMPANY,

FOR THE USE OF J. J. PRYOR, ASSIGNEE.

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The plaintiff, the Mechanics' Savings Bank and Trust Company, by its attorney, Edward H. East, comes on this the nineteenth day of January, 1901, and assigns error, and says that on the record and proceedings in the above entitled cause there is error in this, to wit:

I.

The Court of Appeals for the Sixth Circuit committed error in allowing the defendant credit for $5,992.35, on his bond as Cashier, the proof showing that this sum was a part of his defalcation, under the terms of said bond.

II.

The Court erred in not finding and holding from the proof, and upon a full construction of the bond, that the default of Schardt, accomplished by embezzlements, under the bond as Cashier, was $22,964.17, committed during the currency of said bond, viz.: between January 1, 1893, and April 17, 1893.

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No. 617.

No. 792.

# United States Circuit Court of Appeals.

SIXTH CIRCUIT.

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## *The Guarantee Co. of North America*

VS.

## *Mechanics Savings Bank and Trust Co., to use of James Pryor, Assignee.*

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In Error to Circuit Court of Appeals for the Sixth Circuit.

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BRIEF OF

EDWARD H. EAST,

SOLICITOR FOR DEFENDANT IN ERROR.

MARSHALL & BRUCE CO., NASHVILLE, TENN.

Ten copies Letter sent by Mr. East
+ distributed to Court.

# United States Circuit Court of Appeals

FOR SIXTH CIRCUIT.

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**Guarantee Company of North America,**
*Plaintiff in error,*

v.

**Mechanics' Savings Bank & Trust Co., for use, etc.,**
*Defendant in error.*

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## STATEMENT OF CASE.

*May it please the Court:*

This appeal is taken from the Circuit Court of the United States for the Middle District of Tennessee, to review a decree of that court, in favor of J. J. Pryor, assignee of the Mechanics' Savings Bank & Trust Company, against the Guarantee Company of North America, a Canadian corporation, for the amount of two bonds, executed by the Guarantee Company, guaranteeing the bank against loss by dishonesty of its teller, John Schardt, and the same person as its cashier, he having filled the two positions in succession.

The opinion of Circuit Judge Clark can be found in 68 Fed. Rep., 459.

The opinion of the court affirming Clark can be found in 80 Fed. Rep., 766.

The opinion for a rehearing in 82 Fed. Rep., 345.

The opinion of the Supreme Court can be found in 173 U. S., 387.

## IN RE OF TELLER'S AND COLLECTOR'S BOND.

The teller's bond is dated January 16th, 1888, and was renewed from year to year until January 1, 1893. This bond was in the penal sum of $10,000, for which the bank paid $100, and, to effect a continuation of said bond for ensuing years, a like consideration was to be paid by the bank annually, which was done, and the bond was continued current until the 16th day of January, 1893:

The condition of the bond is:

"To make good and reimburse to the employer such pecuniary loss as the employer shall have sustained by the *fraudulent* acts of the employe, in connection with the duties of said office or position, or with any other duties assigned to him by the employer in the said service, committed by him, and discovered during the continuance of this bond, and within six months from the employe ceasing to be in said service."

Rec. 11–15.

There are many conditions and provisions attached to this bond, and agreed to be observed, not necessary to notice in this litigation. I here quote such only as it is insisted are necessary to the adjudication of this case, and are agreed to be "observed and binding as a part of this bond:"

"That this bond is *issued* and *renewed* on the express understanding that the employe has not, within the knowledge of the said employer, at any former period, either in this or other employment, been guilty of any default or serious dereliction of duty.

"That the employer shall observe, or cause to be observed, all due and customary supervision over the said employe for the prevention of default, and if employer shall, at any time during the currency of this bond, condone any act or default on the part of the employe which would give the employer the right to claim hereunder, and shall continue the employe in his service, without notification to the company, the said company will not be responsible hereunder for any default which may occur *subsequent* to said act or default of said employe so condoned.

"That the employer shall at once notify the company, on his becoming aware of the said employe being engaged in speculation or gambling, or indulging in any disreputable or unlawful habits or pursuits.

"That there shall be *an inspection* or audit of accounts or books of the employe on behalf of the employer at least once in every twelve months from date of this bond."

The bond also declares in its preamble the following:

"And, whereas, the employer has delivered to the company a certain statement, and it being agreed and understood that such statement constitutes an essential part of the contract hereinafter expressed."

This statement is nowhere identified or more definitely pointed out. It is a separate and distinct paper from the bond.

The guarantee company contends that the paper referred to is the one signed by C. W. Peden, the then cashier of the bank, as this was the only paper delivered to the company either before or contemporaneously with the execution of the bond, and which consists of questions and answers.

On this theory, I now quote from it such questions and answers as are supposed to enter into this lawsuit:

Question 8. What is your custom in regard to frequency of *inspection?* Are they at stated periods or irregular, and what is the longest time allowed to elapse between inspections?

Answer. Every quarter.

Question 9. Has the bank a duly appointed and authorized inspector or inspectors? If not, by whom are the inspections made?

Answer. The finance committee.

Question 18. In the event the employe filling the post of teller, how often, and by what officer will the teller's cash be checked and counted?

Answer. By finance committee quarterly.

Rec. 105–6.

The questions and answers are concluded by this declaration:

"I hereby declare that the answers and representations above made are true, and that I am not aware of any matter or thing

affecting the character or reputation of the applicant which should create any doubt as to his reliability or trustworthiness.

"Dated at Nashville, Tenn., this 21st day of January, 1888.

"(Signature) C. W. PEDEN,
Cashier, on behalf of bank."

Rec. 106.

There is no effort in this bond to make these answers and declarations warranties. There are no warranties in this bond.

The teller's bond was renewed from year to year by the payment of the $100 by the bank, and without any specific questions or answers additional, but before the bond was renewed each year, the defendant company sent out to its patrons a printed circular, in which, among other things, was the following:

"It is necessary, before the bond can be renewed, that you obtain the certificate on the back hereof, by your president or cashier, and on its return with remittance of the premium, the renewal can be immediately effected."

Stipulation, Rec. 103.

The certificate on the back was filled up and signed by the *cashier*, and among other things, it stated that the accounts of said teller, Schardt, had been *examined* and *verified* by the finance committee of said bank, and the bond was not renewed any year until this certificate had been made out and delivered to the defendant company.

Rec. 106.

This statement only applied to the teller's bond.

The embezzlements as teller and collector commenced September 12, 1890, and continued during the currency of the several bonds, successively, to January 1, 1893, when Schardt became cashier, vice Sykes, resigned.

The embezzlements, as shown by the experts, are subdivided, as follows:

| | |
|---|---|
| From Sept. 1, 1890, to Jan. 16, 1891 | $ 5,879 34 |
| From Jan. 16, 1891, to Jan. 1, 1892 | 22,290 00 |
| From Jan. 1, 1892, to Jan. 1, 1893 | 50,649 90 |
| Total (record, 33) | $77,819 24 |

## HOW EMBEZZLEMENTS WERE COVERED ON THE BOOKS.

These various embezzlements were covered on the books of the bank, and detection prevented:

1. By false additions.
2. Failure to enter notes discounted.
3. Failure to enter money collected.
4. Failure to give proper credits to depositors on the books of the bank.
5. Failure to credit on the books of the bank interest paid on notes.

Rec. p. 34, q. 4; Rec. 48, q. 10.

Nearly all of the embezzlements were covered on the books by misstating the amount due depositors upon the books kept by Schardt.

Rec. 38, q. 14; q. 39, q. 33.

The expert, McEwen, and others, when asked if these abstractions and embezzlements were easily detectable from the books of the bank, testified:

"They could have easily been detected by an expert bookkeeper. His falsifying of the books was done, in main, in false additions on the cash book, and whenever this was done he nearly always falsified the general account of individual depositors on his general ledger, to correspond with the errors made on the cash book. A few of his false additions on his cash book were covered up by falsifying one or more of his other accounts on his general ledger. The amount shown as due individual depositors by the account on the general ledger, was far less than that actually shown to be due by the pass books of depositors."

Rec. 34, q. 5.

The two expert bookkeepers (McEwen and Jennings), with their assistants (Fisher and Northern), were engaged in this work "several months."

Rec. 34, q. 7.

It was necessary to refer to various and different books. (Rec. 34, ques. 9.) All pass books had to be called in. (Rec. 34, ques. 10.) In some instances no deposit tickets could be found.

Rec. 35, q. 11.

BOOKS KEPT BY THE BANK (Rec. 35, ques. 4).

1. Individual ledger, kept by a clerk.
2. General ledger, kept by Schardt until made cashier.
3. Cash book, kept by Schardt until made cashier.
4. Daily balance book, kept by Schardt until made cashier.

Pryor gives the books kept by the bank, as follows: General ledger, individual ledger, cash book, deposit register, check register, discount register, and such auxiliary books as experience showed to be necessary.

The individual ledger showed the deposit account of each individual depositor.

General ledger shows every account in the bank except that of individual depositors, viz.: Demand loans, discounts, bonds, stocks, and such. It has also an account showing in totals the deposit made and checked out each day by individual depositors. This book was kept by Schardt from beyond 1890 to the time the bank closed (April 17, 1893).

The cash book shows the same things as the general ledger, except that instead of putting the business of each day under various accounts, they are grouped together on one page in

the cash book, and shows at a glance the entire business transacted by the bank during the day.

This witness testified that the fact that Schardt was permitted to keep the general ledger and act as general bookkeeper in the bank, greatly increased his facilities for embezzling the funds of the bank. (Rec. 38, ques. 16.) Also, he was asked: "Would it have been possible for Schardt to have embezzled funds of the bank to any extent without detection if he had not been permitted to keep the general ledger?" The answer is: "It would not have been possible for him to embezzle the funds in the maner he did if he had not been permitted to keep the general ledger and balance book." (Rec. 39, ques. 20).

It will be observed that what is designated herein as the teller's bond, was given upon the idea that Schardt had been assigned to the office or position of teller and collector, and covers any pecuniary loss which the bank shall sustain in connection with the duties of the said office or position, or with any other duties assigned him by the employer in said service.

This witness was asked concerning a trial balance book, said: "I saw a book of that character when I went in there, but it was incomplete, the balances not entered up, and I paid no attention to it, and I do not know for what years they were taken off." (Rec. 39, ques. 21.)

This trial balance book was left off in 1890 by the orders of Schardt. (Rec. 75, Boensch Dep., ques. 6; ques. 15.)

In the examination of these witnesses, many hypothetical questions were put by the defendant as to how, and whether these embezzlements might have been easily detected had the officers of the bank suspected Schardt, and resorted to them, all of which resulted in negative answers, except as follows: One expert said: "They could, upon any day, at close of business, have taken the daily balance book showing a record of

the condition of the bank at the time, and counted the notes on hand, bills receivable, bonds and stocks, and cash, and could then have verified the amount appearing to be upon deposit in other banks to the credit of complainant bank, and this would have only left to be verified the amount shown to be due depositors, and the way to verify this would have been to have taken from the individual ledger a trial balance, which would have shown the amount due depositors by the bank, and if this had agreed with the amount appearing upon the daily balance book to be due depositors, the officials of the bank would have verified his accounts as clearly as possible." (Rec. 38, ques. 12.) This, he said, should not, in a bank of that size, have taken over twelve hours. (Rec. 38, ques. 13.)

The other expert (Jennings), said: "No person not an expert bookkeper could have found many of those manipulations, but it would not have been difficult for any one who could add columns to have seen some of these false additions, which would have resulted in causing suspicion that some wrong was intended."

Rec. 49, q. 11.

Jennings also testified in respect to the time it would have taken: "Of course it depends upon the rapidity of the work of the bookkeeper. I should think twenty-four to thirty-six hours would be sufficient for an average bookkeeper to do that work." (Rec. 50, ques. 9.)

## BY-LAWS OF BANK AS TO DUTIES OF TELLER AS BOOKKEEPER.

"The teller shall also be the general bookkeeper of the bank."

The evidence shows that no system of bookkeeping will detect or prevent embezzlements, including trial balances, and that it is not possible to ascertain the financial condition of a

bank without stopping the bank for a time, call in all the pass books, and have an expert go through the whole thing.

Rec. 73, dep. of A. W. Harris.
Rec. 85, dep. of Duncan, q. 33.

The evidence shows that in small banks it is customary for the teller to keep general ledger.

Rec. 82, q. 5, et seq.: Rec. 85, q. 27.

It cannot be contended, in view of this contract, that it was wrong to allow Schardt to keep the book known as general ledger, and that guarantee company can say successfully that this enabled Schardt to commit and conceal his embezzlements. The contract prepared by the guarantee company, and submitted to the bank, is "to make good and reimburse to the employer such pecuniary loss as the employer shall have sustained by the fraudulent acts of the employe in connection with the duties of his said office or position, or with any other duties assigned to him by the employer in the said service."

The proof shows that it is not customary for financial committees, in examinations, to go through original entries on the books, but it is customary for them to accept statements made by cashiers, officers, and clerks.

Duncan dep., Rec. 85, q. 31.
McLaughlin dep., Rec. 82, cross question 2.
A. W. Harris dep., Rec. 73, qq. 3, 4.

There was, at all times, a financial committee consisting of five members; generally three acted.

The evidence shows conclusively that the finance committee made quarterly examinations into the bank's condition, and also semiannual examinations. The main purpose of the latter was to ascertain the ability of the bank to pay a dividend. The mode and extent of these examinations are stated dif-

ferently, but substantially concur. Eatherly says: "Mr. Schardt made out a list of assets of the bank, and that list was taken charge of, generally by myself and a portion of the finance committee. We went to where the securities were kept, and took them to the directors' room, or rear part of the bank, and compared them with the amounts given on the list, to see whether they corresponded. We examined the collateral, or evidences of them, to see if they were there. We counted the cash on hand, and had generally a certificate from the banks where we deposited, to the amounts in those. We then compared the footings with the amount as shown on the daily balance sheet or balance book, to see whether they agreed with them. We found no discrepancies except in cash on hand in a few instances. Generally, there was a discrepancy of a few dollars between the money on hand and the amount shown by the daily balance sheet. Sometimes it was a deficit and sometimes a gain, but generally a deficit." (McEwen's Dep., 90–94.)

This custom was habitual and continuous.

In addition to these quarterly examinations, annual reports were submitted to the directors by the cashier. The president, or some one or more of the directors was present in the bank at all times.

Eatherly admitted that had the finance committee procured from the individual bookkeeper the total amounts shown by his books to be due individual depositors, and compared it with the amount shown by the daily balance book kept by Schardt to be due individual depositors, it would have disclosed the fact that something was wrong with books.

McEwen testified in respect to these quarterly examinations as follows:

"We counted all the money, or things that represented money, such as cash tickets, checks on other banks, deposits in other banks, and compared this with the statements furnished us by the cashier or teller. Then we took possession of all notes, bills, time or demand loans, or other paper showing an indebtedness to the bank, as well as collaterals, and did our best to ascertain the condition of the paper, and value of collaterals. We compared this with statements furnished by the cashier or teller of what should be in the bank of those kinds of paper, and also compared it with the daily balance book. As we had seen all notes or bills which had been discounted by the bank, and these had been entered on the daily balance book, we would sometimes go back to it. We always took the cashier's or teller's written statement of the deposit account. We hardly ever examined original entries of deposits, but accepted this statement as making a full and fair exhibit of these. We could not have examined original entries. There were several hundred depositors, and a great many small accounts with individuals. It would have taken all our time to have done this, and but few, if any of us, were bookkeepers or accountants. We had to rely upon the honesty of the cashier for this. We did our best to ascertain the exact condition of the bank at the end of each quarter. The finance committee was the discount committee, and all paper approved by the committee was recognized by the committee at the quarterly examination. If we did not remember it, we appealed to this book of original entries on the ticket. The quarterly examinations were of the same kind and character which all the banks of Nashville made, as we understood."

Rec. 92, q. 17.

"Every July and January of each year the directors and finance committee made an examination into the affairs of the bank with a view to ascertaining the ability of the bank to pay a dividend. These examinations of the directors and finance committee were as thorough as we could make them."

Rec. 93, q. 23.
J. B. Richardson dep., Rec. 94.
Rec. 90, q. 3.

The defendant company had a general agent (Cooley) resident in Nashville. It is a part of the duties of this general agent to gather information concerning applicants for bonds, and about persons already bonded in defendant company, and to transmit such information to the home office. To this end

the agent employed detectives at discretion, and took information from outside parties.

## ASSIGNMENTS OF ERRORS AS RESPECTS THE TELLER'S BOND, AND REPLIES THERETO.

The first assignment is—

"*The bank agreed to immediately notify the company on becoming aware of the employe being engaged in speculation, and the bank learned that the employe had not only been speculating, but had been part owner in a gambling concern, and neither investigated the matter on its own account, nor notified the company.*"

The above assignment is based upon the following condition in the bond:

"That the *employer* shall at once notify the company on *his* becoming aware of the said employe *being engaged* in speculation or gambling, or indulging in any disreputable or unlawful pursuits."

1. This section involves no active duty upon the bank, or its officers or agents to ascertain what Schardt did in respect to these several matters, and only required it to *notify* the company, "on his becoming aware" that he was "being engaged," etc. No character of diligence is put upon the bank. On the contrary, the insurance company, in the language of Chief Justice Lumpkins, of Georgia, "invited the bank to repose in peace, for it guaranteed that Schardt was honest and would remain honest and faithful." Fidelity & Casualty Co. v. Gate City National Bank, 33 L. R. A., 821.

2. The evidence on this point is presented by only two witnesses. Eatherly, a director in the bank, and Sykes, its cashier. Eatherly's testimony is substantially that John Woodward brought an anonymous letter to the bank, and showed it to me, and I asked permission to call Mr. Schardt up and show it to

him. In this letter it was stated that Schardt was a partner in a bucket shop. Schardt read the letter, and said, "it was a lie, and I can prove it." Eatherly reported the letter to Baxter, the president, telling Schardt that it devolved upon him to prove it false. Schardt requested them to remain where they were. Schardt went out and got Frank Searight and Dr. Barry. These two men said that some time *before that* Shardt, Barry, and Searight had agreed to open a brokerage association. Each one was to put in a small amount—$200. Mr. Schardt, in a short time, became dissatisfied and sold his interest to Frank Searight at a small loss. (Rec. 61.)

There is no evidence in this that the brokerage association had a single transaction of any character at any time, and especially while Schardt remained in it.

3. This evidence does not show that a brokerage association was ever, in fact, opened, or did any business, only that they had *agreed to open* such association.

4. This witness locates the time of this anonymous letter as "just prior to the resignation of Judge Woodward" as a director. Woodward's resignation is dated February 17, 1893, and was accepted March 25, 1893. The bond of Schardt, as teller, had expired January, 1893, and none of these transactions relate to the time during which the teller's bond, sued on, was in force, and whatever notice this anonymous letter, or transaction, may have given, was after the bond had expired.

5. Give the whole transaction—the letter—and all that occurred, full credence, and it amounts to this: that Schardt and two others agreed to take stock to the amount of $200 each in a brokerage association, which the evidence failed to show was ever organized, or had a single transaction.

6. Brokerage associations neither buy or sell for themselves, but buy and sell on commissions for others, who do the specula-

ting and gambling, on the boards of exchange in distant cities and States where it may be lawful to do so.

7. Brokerage associations were licensed in the State of Tennessee to deal in futures at the time of these alleged transactions.

See appendix to this brief of the Acts of the Legislature, and the construction thereof by Tennessee Supreme Court, 16 Pickle, 79, holding the license to be valid.

8. Proof that a person was a stockholder in an active and going brokerage association would not necessarily prove that he was gambling or speculating or indulging in any disreputable or unlawful habits.

Scott v. National Bank, 72 Pa. St., 471.

9. The next witness called on this point was Charles Sykes. This witness was the cashier of the bank from December, 1889, to January 1. 1893, and had recommended Schardt to the directors to be his successor in that office when he retired in January, 1893, and upon this Schardt was elected and did take the office at that time. Sykes had been (as a cashier always is) the chief manager of the bank for three years, with full supervision over Schardt and the books kept by Schardt. Sykes had signed and certified the certificates for the annual renewal of Schardt's bond as teller. At the time this witness was called as such by the defendant in error, there was pending a litigation on behalf of the bank, by the assignee, against him. He was asked if, during the year 1892, he received any information that John Schardt was speculating. His answer was: "Some time in the summer or fall of 1892, a gentleman by the name of Kyle came here (Nashville) from New York, representing Myers & Co. Kyle wanted me to become interested in the brokerage business, and represent Myers & Co. at this point. I told him I did not like the idea, because it would be purely a speculative business,

and he then said that that made no difference; that John Schardt, *our* teller, was a part owner in a similar concern." He was then asked if he "had imparted this information to any one." His answer was: "Yes, sir; I *once* told Mr. Baxter, the president of the bank, of this conversation." He was then asked if he told Schardt what Kyle had said. His answer was: "Yes, sir; on the *next day*. I think I told Schardt what Kyle had said," and that Schardt "admitted that he had at *one time* been interested in such a concern, but had sold his interest, and that he had speculated to some extent, but had made money on every transaction, and had seen the error of his way, and had ceased to do so any more." He says that he "*immediately* told Mr. Baxter, the President of the bank, *what Schardt had said.*" Sykes further testified that "some time thereafter I received an anonymous letter telling me that Schardt had been speculating," which letter he says he showed to Baxter, who told him "not to pay any attention to an anonymous letter."

Record, 77–79.

This witness' deposition was taken about May 15, 1895. The matters about which he gave his testimony had occurred in the "summer or fall of 1892." His deposition was taken to fasten notice on the president, Baxter, and thereby on the bank, of the fact that Schardt had been a part owner in the "brokerage business." He said: "I once *told* Mr. Baxter, the president of the bank, of this conversation." When did he tell Baxter? Before or after the bank assigned? Before or after the expiration of the bond? Why does he not say when it was? Why was he not asked *when* it was? He remembers, he "thinks," that he talked to *Schardt* about the Kyle conversation "the next day" after it occurred. He remembers that he "immediately" told Baxter that Schardt admitted that he had *at one time* been interested in such a concern—i. e., brokerage business

—and that he *had speculated* to some extent, but had made money in every transaction.

10. Do the foregoing constitute "becoming aware?" The word "aware" is not used in this policy, as the word "heard" is used in the cashier's policy. Nor is the word "aware" the synonym of *heard*. Aware is universally defined as "possessing knowledge," "conscious," "cognizant," "informed through the senses," but is a synonym of "certain," "certified," "sure."

Employers are not required to make charges against their employes by giving notice to the sureties of the latter upon *suspicion*, "but only after the bank had knowledge of such facts as would justify the charge."

American Surety Co. v. Pauly, 170 U. S., 131.

11. It is said that the bank did not pursue or investigate these vague and anonymous charges. The bank had not agreed to do so. It had not so covenanted in its bond. It is quite clear that the bank was not obligated under this contract, or independently of it, to ransack Schardt's past life, or to run down rumors and suspicions, and make written reports of them to the company. The insurance company had its agent—Cooley —at Nashville to do this character of work.

State v. Atherton, 40 Mo., 207.

12. There can be no doubt that Schardt abstracted a very large sum of money from this bank, but that he ever lost one cent in gambling or speculations has not been specifically proven in this record. Not a single instance of either has, as a fact, been proven, and had he not told Eatherly on his death-bed that he lost the money "speculating in New York," we would be left to surmise as to how it went. This confession was made after the bank had closed its doors and had ceased to do business.

## II.

## SECOND ASSIGNMENT OF ERROR UPON THE TELLER'S BOND IS:

"*The bank procured the teller's bond to be renewed in January,* 1892, *by representing that the employe's books and accounts had been examined and verified, when the books showed a default of* $23,364.44 *in a bank with a capital of only* $50,000.

1. Our opponents insist that upon each annual renewal of the teller's bond, the company sent out from Montreal a circular to the bank, which it was necessary for some officer of the bank to sign and return, and that among many other things contained in said circular, were the following: "The accounts of said teller (Schardt) had been examined and *verified* by the finance committee," and that this was a condition precedent to the renewal. That, in fact, the account had not been examined and verified; and, therefore, it was a falsehood, and deceived the company in the issuance of the bond, being a material and important fact.

We say that the original contract made all arrangements for these renewals, and fixed in advance the terms and conditions thereof.

Its language is:

"Now, therefore, in consideration of the sum of one hundred dollars, lawful money of the United States of America, to the said company (paid), as a premium for the term of twelve months, ending on the sixteenth day of January, 1889, at twelve o'clock noon, *and in order to effect a continuance of the currency of this bond,* a like premium hereafter to be paid to the said company on or before the sixteenth of January in each year, as a premium for the ensuing year, so long as said employer may wish to continue this bond, and the said company shall consent to receive said premiums," etc.

Here is no reservation for either party to alter the contract, and no notice that there would be any effort to change it. On the contrary, the parties agree to annual renewals upon "the payment of a like premium *hereafter* to be paid to the said company so long as the said employer may wish to continue this bond, and the said company shall consent to receive said premiums."

Cumulative to the above, the bond recites:

"The following provisions are also to be observed, and binding, as a part of this bond. The actual payment of the premium, and its acceptance by the company, either for the issue or renewal of this bond, is essential to its currency, and a condition precedent to the right or claim hereunder."

Again, we have: "That this bond is issued and *renewed* on the express understanding that the employe has not, *within the knowledge of the employer*, at any former period, either in this or any other employment, been guilty of any default or serious dereliction of duty."

The foregoing constitute all the conditions for the annual renewal of the bond. After the expiration of a twelve month, the contract is to be renewed. As respects *time*, a *new* contract is made, but it contains only the terms of the old contract. May says it is generally held to be a new contract upon the terms and conditions stated in the policy expired, the old application, in the absence of evidence to the contrary, serving as a basis of the new contract, and as if made at the date of renewal.

May on Ins., sec. 70 a.

As respects the "examination and verification" of the books or accounts of this office, not one word is said in the original bond. I now quote what it does say:

"That there shall be an inspection or audit of the accounts or books of the employe on behalf of the employer at least once in every twelve months from the date of this bond."

2. The company had put a number of questions to the officers of the bank, which were to be, and were, answered, to ascertain, before taking the risk, the habits of the bank in respect to these very matters, such as "when was the last *inspection* of the office?" "What is your custom in regard to the frequency of *inspection?*" "Are they at stated periods or irregular?" and "What is the longest time allowed to elapse between inspections?" "Has the bank a duly and authorized inspector? If not, by whom are the inspections made?" "In the event of the employe filling the post of teller, how often, and by what officer will the teller's cash be checked and counted?" And to conclude it all, the contract declared in express words: "That there shall be an inspection or audit of the accounts or books of the employe, on behalf of the employer, at least once in every twelve months from the date of this bond."

This circular, which contains the words, "examination and verification," it is now claimed requires more of the bank than was required by the original contract, or than is expressed by the words, "inspection or audit," and an effort is thus made to alter the contract in a sidewise, unadvised, and unconscionable manner.

Our contention is, that under this contract the bank was required to do certain things in respect to the books and accounts of its teller, and these things, we claim, it did, and this contract was to continue from year to year, upon the payment of the premiums, so long as the one paid and the other accepted it. At the end of the year, and when the bank had determined to continue the contract for another year, and to pay the premium, this paper, not purporting to change the contract or the duties of the bank, then past and ended, came to the bank, and hidden in it are the words, that the teller's accounts had been "examined and verified" by the finance committee, whatever these words mean. We insist that said statement in respect to "verification,"

was not a condition of the original contract, as set out in the bond or guaranty; was not called for therein as a condition precedent to renewal, but was intended as a catch, slyly and cunningly devised to defeat ultimate liability, and to entrap the unwary. Judge Wallace aptly illustrated this practice of some insurance companies inserting fatal conditions in unsuspected places. He said: "It was probably inserted where it is found with the purpose, on the part of the insurance company, of escaping any liability in the event of a loss, if it should see fit to do so. But it is inserted in a part of the policy where it would not naturally convey that meaning to the insured." Hogan v. Aetna Ins. Co., 95 Fed. Rep., 106.

3. We further contend that the words of the original contract are the contracting and controlling words of the parties, measured by each before executing the contract, and fixed forever their rights and duties under *that* contract so long as it existed, as between themselves, and that its legal effect was not to add anything to the contract as a condition or provision, but should be construed in connection with and to have reference to the words, "inspection or audit," as set out in the original contract. That having required the bank to perform specific duties in the original contract, it cannot subsequently limit its liability and defeat the entire contract by requiring the bank to do those same things by using stronger words, or increasing the bank's duties beyond its original contract. Nowhere in the original contract had it exacted of the bank a "*verification*" of the accounts of the teller. "Verification," as now contended for, means such an examination and comparison, inspection and scrutiny of the books and accounts of the teller as would detect any embezzlements, however cunningly contrived or hidden upon the face of the books. If these companies will make it apparent or visible upon the face of the contract what is now

and here contended for, they will quit the field of competition for business and patronage quite soon.

The condition of the original contract, and of each renewal was: "That there shall be an *inspection* or *audit* of the accounts or books of the employe, on behalf of the employer, at least once in every twelve months from the date of this bond." This is what the bank agreed to do, and this is what it understood it was certifying it had done. It is argued here as if the bank had made a contract for such effective and absolute supervision as would detect and prevent abstractions of its funds, and in this circular solemnly certified that it had done so, and the bond was renewed on the faith of this statement, as if it was a guaranty on the part of the bank that the past was forever closed, and that the bank had somehow estopped itself from looking into past embezzlements, and that it would be a fraud on its part to insist thereafter that there were or had been embezzlements.

The court will observe that the very words of the contract put the only limitation upon retro-examination and discoveries in this language: "Committed by him and discovered during the continuance of this bond, and within six months from the employe ceasing to be in said service" (Rec. 12), showing thereby that back inspection of the books of the employe were intended, notwithstanding a renewal in the meantime. The effect of the contention of our opponents, in view of all the facts, is this: The bank agreed to make an "inspection or audit" once in every twelve months, and then at the end of the twelve months, to make the bank say that it had "examined and verified."

5. The attention of the court is called to the fact that the cashier, Peden, during his term of that office, and Durr as his successor, and Sykes as his successor in the same office—the several cashiers—are the persons who signed and returned to the

company the circulars sent out annually, stating that the accounts of said Schardt, as teller, had been examined and verified by the finance committee.

(See Stipulation, p. 106, of Record.)

As it is insisted that the circular made a change in the original contract, which we deny, but if it does, then we insist that a cashier had no power to make such a change, and for this insistance, we rely upon the following:

American Surety Co. v. Pauly, 170 U. S., 133.
Fidelity, etc., Co. v. Gate City, etc., 33 L. R. A., 821.

The original contract did not anticipate that it was to be changed by any one, much less by a cashier unwittingly.

## III.

The third assignment on teller's bond is:

*"The bank agreed to observe, or cause to be observed, all due and customary supervision over the said employe for the prevention of default," and during the currency of the bond ceased to compare ledger balances, or correctly count the notes held by the bank, which was not only customary with other banks, but was customary in this bank up to the time the shortage commenced."*

This assignment is based upon the following provision of the policy:

"That the employer shall observe, or cause to be observed, all due and customary supervision over the said employe for the prevention of default, and if the employer shall, at any time during the currency of this bond, condone any act or default on the part of the employe which would give the employer the right to claim hereunder, and shall continue the employe in his service, without notification to the company, the said company will not be responsible hereunto for any default which may occur subsequent to said act or default of said employe so condoned."

1. Our reply is: This is a very broad and indefinite expression, and is easily susceptible of several interpretations.

"*All due and customary supervision over the said employe for the prevention of defaults,*" it is now contended by the company, that it is susceptible of but one meaning or interpretation, and that it relates alone to "*a comparison of ledger balances, or to correctly count the notes,*" and that herein the bank covenanted that it "would compare ledger balances," and that it would "correctly count the notes." If that be its meaning, it is the poorest and most meager expression of that thought ever recorded. It is an intellectual alibi to the original.

It says nothing in respect to the books, comparing the same, or counting notes. "Supervision *over the employe*" for, etc. Literally, it has no reference to books or notes, but does refer personally to the employe as respects his daily habits, associations, morals, his prompt and daily presence at the bank at the usual and customary hours. When construed in connection with its context, it is clear that it refers to the *person*, and condonation of his acts and defaults. The balance of the sentence is consistent with this view and inconsistent with the contention of the company.

2. It is now a universal principle of law in the construction of papers written by insurers or guarantors intended for the public to accept as written, that all ambiguities, obscurities, and uncertainties are to be construed against them and in favor of the public or insured, and if the paper is open to two constructions, the courts will give it that construction most favorable to the insured.

American Surety Co. v. Pauly, 170 U. S., 132.
Imperial Fire Ins. Co. v. County of Coss., 151 U. S., 452.

3. Again, the company had made inquiry and been told all it desired to know in respect to the books of the bank—i. e., when they were inspected, by whom they were inspected—and had put its ultimatum to the effect that they should be *inspected* at least once in twelve months. The bank had made full disclosures of its modes in this respect, and told every fact it was asked in regard to its books, inspections, etc. The insurance company, after hearing thus from the bank, prescribed nothing additional, nor did it prescribe either the extent, vigilance, or scrutiny of the inspection, or how it should be done, and what it would expect the bank to do additionally.

4. Beside, the insurance company had been told in the application for the policy, which application and all the questions therein it had prepared and submitted, that there would be an "inspection or audit of accounts or books of *the employe*, on behalf of the employer, once in every three months," and was content to issue the policy on this; at the same time it was told that this would be done by the finance committee.

5. There was no agreement that the books of other officers or clerks would be compared with his.

33 L. R. A., 821; 30 Id., 581.

6. The only limit upon the extent of the liability of an insurance company must be found in the clear and unambiguous language of the contract. *Indemnity* is the purpose of the contract. This is what the premium is paid for, and there can be no inference against full indemnity. Every condition or proviso intended to defeat all indemnity, or to forfeit the policy, will be strictly construed.

7. It is said by our opponents "that if an employer *knows* that an employe has been guilty of dishonest conduct, and conceals the information from the contemplated surety, the bond is void, whether the intended surety made inquiry in respect to the same or not."

I do not concede such to be the law, but if it were such, it would not militate against the bank, for the reason it will not and cannot, from the record, be stated that the bank, or its president or directors, *had knowledge* of Schardt's dishonesty and previous defalcation.

Other adjudications hold differently from the above annunciation.

6 Peters, 217; 11 Wheat., 59; 22 U. S., 93; 9 R. I., 168; 52 Pa. St., 343.
Frelinghuysen v. Baldwin, 1 Pet., 452.
Magee v. Manhattan Co., 92 U. S., 95.

8. **The real question in this case is not that stated above, but is this:** The books of the bank would reveal to expert accountants, upon a vigilant examination, that Schardt was a defaulter, but this fact had never been suspected by the president or directors of the bank, or any one else. It is generally held by the courts "that negligence of the bank, or its officers, in failing to examine the books, and to discover the defalcations of its officer or clerk, does not release the sureties on his bond given for the faithful performance of his duties."

Lieberman v. First National Bank, 40 Atl., 382.
Bank v. Root, 2 Mete. (Mass.), 540, by Shaw, C. J.
Taply v. Martin, 116 Mass., 275.
Bank v. Stephens, 39 Me., 532.
Farmington v. Stanley, 60 Me., 472.
United States v. Kirkpatrick, 9 Wheaton, 72.
Wayne v. Bank, 52 Pa. St., 343.
Phillips v. Bossard, 35 Fed. Rep., 100.
Sparks v. Bank, 3 Del. Ch., 302.

Graves v. Bank, 10 Bush (Ky.), 23, has been overruled in every case in which it has been discussed, and stands alone and unsupported.

Lieberman v. First National Bank, 40 Atl., 386.
Bank v. Albee, 63 N. H., 161.

## IV.

## ASSIGNMENT ON TELLER'S BOND.

This assignment is in this language:

*"The bond provided that there should be 'an inspection or audit of the accounts or books of the employe on behalf of the employer at least once in twelve months,' yet the ledger balances were not compared, and the notes in the bank were not counted or compared with the amount called for by the books. Every page in the books kept by him was incorrect, and no inspection or audit of his books or accounts was made."*

This assignment is based upon the following condition of the teller's bond:

"*That there shall be an inspection or audit* of the accounts or books of the employe on behalf of the employer at least once in every twelve months from the date of this bond."

We reply:

1. This assignment is not well taken in fact. That there was an inspection or audit, as the bank understood these words, every three months, and also every six months, additionally, there can be no doubt, and surely either of these would be a compliance with the agreement, "at least once in every twelve months."

2. The real point of this complaint is not that the bank did not continue the inspections or examinations as it did at the time the first policy was issued, and as it had done before that time, and continued to do afterwards, but that all these inspections, or audits, were too superficial to meet the requirements of the contract.

I have great confidence that any examination of the books of the employe which fell short of detecting and exposing his defalcations, would, in the estimation of the company, have been

too superficial, and not a compliance with its idea of what was required.

It is claimed that what examination the bank made did not amount to either an "inspection or audit," as these words are now understood by the company.

In proof of this we are referred to the fact that original entries on the books were fraudulent; that the books were full of false additions, and other frauds, which a more expert and scrutinizing inspection ought to have discovered.

Since the experts, McEwen and Jennings, assisted occasionally by another, have labored on these books for several months, called in all the pass books of depositors, explored original entries, uncovered those which were false, pointed out every false addition made of long columns of figures, and exhibited failures on the part of this employe to enter upon the books moneys paid to the bank, and how, after having made false entries in one book, he would falsify entries in other books in order to prevent detection, and make them correspond as a whole, it is quite easy now to see how these might have been detected by the finance committee, and how apparently negligent this committee was in not discovering them before. Our *ex post facto* information reflects back and sheds light upon things not seen before, and enables us to see things lying now upon the surface the very existence of which we never suspected before.

These expert bookkeepers having dragged from their hiding places fraudulent entries, and pointed out their relations to other entries, and shown the false additions, our adversaries say joyfully: "See, how easy it would have been to have detected them!" And the finance committee is made to rest under the aspersions of stupidity, dullards, and negligent officers, though it was their money which was being abstracted.

3. The argument of our opponents is, that the books kept by Schardt had hidden, under their surface, every false entry now brought to light, and that these entries were as open to the discovery of the finance committee as they were to the experts, and but for the *negligence* of the finance committee in failing to make an expert examination would have been discovered at an earlier period, and before the losses became so large, *ergo*, the finance committee did not make the contemplated inspection or audit. This court replied to that argument in this language: "This is substantially construing the contract as a guaranty to the defendant company against the bank's carelessness in making the examination," and I might add as guaranteeing to the company that each quarterly inspection closed all matters to that date.

4. Insurance is taken to secure the insured against his own negligence or inexpertness, as well as that of his agents, servants, or committees. The contract nowhere calls for infallible inspection. If such they had to be, there would be no necessity for insurance.

5. It is said that it contributed to the teller's opportunities to embezzle, successfully, the moneys of the bank, and avoid detection by allowing him to discontinue the trial balance book in 1890. So, it contributed to his opportunities to embezzle by employing him at all, or in allowing him access to the money of the bank. It was never contracted that the bank would have a trial balance book, or any other particular book. No inquiry was made as respects the number, character, or office of any book, but only that such books as were kept should be "inspected or audited at least once in twelve months."

6. I do not understand how, if original entries were false in one book, and all the other books were made to conform to this fraud, how a trial balance book taken from these false entries, or *vie versa*, would have prevented the fraud or detected it. The

company did not guarantee his honesty on condition a trial balance book was kept, or that the bank would so order and arrange books and compare them that he could not embezzle without detection, but did guarantee that he would not be guilty of embezzlement.

It seems now probable that Schardt dropped the use of this detective trial balance book as a part of his scheme to embezzle the money of the bank, or because of the additional labor it would require to make it conform to false condition of the other books. If he would falsify one book, he would another.

7. Certain it is the honesty and fidelity of Schardt was the fact insured, not honesty so hedged about that he could not be dishonest: not honesty *compelled* and *enforced* by active and sleepless vigilance; not fidelity extorted by an impending threat that an expert accountant would be put and kept upon his tracks, at a greater expense to the bank than the premium paid annually for this insurance.

8. It is generally known that there are two modes of inspecting the books of a bank officer or clerk. One is that made by the finance committee of the bank, which never goes to original entries, never adds up columns, or calls in pass books, but accepts as correct statements furnished by the cashier purporting to be taken from original entries. The other is that made by expert bookkeepers, who do go into original entries and make comparisons of the entries made in various books and which bear upon each other, and adds up long columns of figures, calls in all pass books of depositors, and compares entries made in them with entries in the individual ledgers.

9. It was clearly understood by the company, from the questions and answers disclosed in the application, that inspections had been made by the finance committee, and that this would continue in the future, and no objection was made. It is fair

to infer that the company knew that the finance committee of banks was made up from the body of the shareholders, and was composed of those largely interested, pecuniarily, in the success of the bank, and the company was willing to leave it to such a committee to make inspections. Judge Clark held on this point: "So long as the bank officers and committee acted in good faith, such examinations as the finance committee thought sufficient for the protection of the bank and its stockholders would satisfy the requirements of this contract. If anything more was wanted, it was a matter for specific agreement."

10. It is pressed with zeal and repetition upon the court that "ledger balances were not compared," "or the notes of the bank counted or compared with the number or amount called for in the books." Here is the evidence on these points:

John A. McEwen, a member of the finance committee, testified:

"A. We counted all the money, or things that represented money, such as cash tickets, checks on other banks, deposits in other banks, and compared this with the statement furnished us by the cashier or teller. Then we took possession of all notes, bills, time or demand loans, or other papers showing an indebtedness to the bank, as well as collaterals attached, and did our best to ascertain the condition of the paper and the value of the collaterals. We compared this with a statement furnished by the cashier or teller of what should be in the bank of these kinds of papers, and also compared it with the daily balance book. As we had seen all notes or bills which had been discounted by the bank, and these had been entered on the daily balance book, we would sometimes go back to it. We always took the cashier's or teller's written statement of the deposit account; we hardly ever examined original entries of deposits, but accepted this statement as making a full and fair exhibit of these. We could not have examined original entries. There were several hundred depositors, and a great may small accounts with individuals; it would have taken all our time to have done this, and but few, if any of us, were bookkeepers or accountants; we had to rely upon the honesty of the cashier for this. We did our best to ascertain the exact condition of the bank at the end of each quar-

ter. The finance committee was the discount committee, and all paper approved by the committee was recognized by the committee at the quarterly examination. If we did not remember it, we appealed to this book of original entries on the ticket. These quarterly examinations were of the same kind and character which all the banks of Nashville made, as we understood."

James B. Richardson, another member of the committee testified:

"A. At these meetings there was always present either all of the committee, or if not all, certainly three of us were present before we commenced the examination. We always counted the cash, and cash items, all notes, time or demand loans, bills, and every paper due the bank was produced and examined, credits on the back of each taken off—all collaterals examined, and estimated values put upon the collaterals, all aggregated and compared with the daily trial balance book. The daily balance of individual deposits and certified checks and bills payable as shown on the daily balance sheet, as exhibited by the cashier, were examined. We did not go to original entries in the individual ledger, but accepted the statement, in writing, of the cashier for this. To have gone to original items and added up columns would have required an enormous expense, and much more time than could have been given it by directors, or its committees, and it is not the custom or habit of committees to examine original items and entries, I understand, in this respect, but to accept the written statements of the cashier as correct. In addition to this, we, individually, would, at times, go into the bank and look over the individual ledger in a general way, as well as the general ledger. I did this and have seen others do it. In addition to this, the cashier would make semiannual reports to the directors, which were examined. These reports accorded with the results of the quarterly reports, and were passed on by the board of directors. These reports related to the general condition of the bank, showing its financial status, and what had been made, and what had been lost during the preceding six months, and showed in general detail the facts upon which such a result was obtained. It purported to be a complete report in every respect, and upon this depended the ability of the bank to declare and pay a dividend or not."

This finance committe was the discount committee, and had seen all the notes or bills which had been discounted, and these had been entered on the daily balance book.

11. Exhibit X. (pages 15-24 of Record) shows every item of the default which the experts charged to Schardt, what book the same can be found in, and the page, and by what manner it was accomplished. The court will see from the said exhibit that "an overwhelming part of the defalcation of Schardt was caused by misstatements on the books kept by him as to amounts due individual depositors." Rec. 39, ques. 23, ques. 24, 34, ques. 4, page 38, ques. 14, says nearly all of the shortage was covered by misstating the amount due depositors. The *notes* which he manipulated in his own interest amount to $ , and are set out as follows: Collected on demand loan John Thompson, $590, credited it on the demand loan, but not on cash book. A. W. McClure, $25, collected on note, credited the note, but failed to enter it on cash book. The two above were made in 1893. (See Rec. p. 19.) The next six items are small notes. He collected these and gave up the notes, but failed to enter the collections on cash book. The next eleven items were like the last. In 1892, he collected on a note of C. H. Brandon, $250, credited the note but failed to enter credit on cash book. The court thus sees that of the several hundred of items composing the abstraction only about seventeen items are connected with notes, and these are scattered over three years' of time, and comparatively amount to but little. John A. McEwen tells how this might have occurred. (Rec., 92.) The committee would call for all notes, etc., and the cashier would hand them the entire package. The cashier at the same time would hand them a list of all the notes that should be in the bank. The notes were compared with the list. If the cashier had put down more or fewer notes than there were the committee would discover it, but, if both were identical in number, it would create no suspicion. Every one of this character of embezzlement occurred—i. e., in which the notes were taken—occurred in 1890, while Sykes was cashier, and may have, or not, furnished the list. If a payment

had been made on a note, in all cases the note was credited, but no entry was made on the cash book (C. B.) by Schardt, and he put the money in his pocket.

The evidence is overwhelming that in no bank do the finance committee explore the books for original entries, but universally accept the written statements and reports of the cashier or other executive officer who acts for him when he is sick or absent.

A. W. Harris, p. 73, q. 3, 4.
McLaughlin, p. 82, cross-ques. 2.
Duncan, p. 85, q. 31 and 37.

"It is not the business or duty of directors to go back to original entries."

Briggs v. Spaulding, 141 U. S., 132.

*The argument is made that while the bank had only* $50,000 *of capital, it lost by Schardt's defalcations more than twice its capital stock—more than* $100,000—*in the years* 1890-91-92, *and to April,* 1893, a little over three years, and this is presented to the court as proof of great negligence on the part of the finance committee.

Baldly stated, it would seem so.

This, however, is readily accounted for when the facts are considered:

1. Nine-tenths or more of the embezzlements were taken from depositors and from payments made on notes and bills while the money was passing from the hands of the depositor, or the payor, to the bank, and properly entered upon the pass books, or credited upon the notes, but not entered at all on cash book, or if entered on cash book, was entered for a false amount. So it was impossible to ascertain the amount of embezzlements until the pass books were called in, and the notes traced to original entries. In some cases no deposit ticket could be found. To these were added false additions of long columns, and corre-

sponding alterations of the books to make them apparently harmonize with each other. It is hard to imagine greater confusion or more ingenious methods.

In this view, the question put to Mr. Harris, on cross-examination, was hardly a fair one. It was: "Do you think that any scoundrel could steal the full amount of your capital stock and surplus without detection?" (Rec. 73.)

I can easily imagine that a bank with a small capital stock and a large daily deposit, with several hundred depositors, made up of laboring people, whose daily deposits were small, by the dishonesty of its teller in appropriating each deposit in whole or part, and making no entry, or a false one, on the books—to say nothing of other manipulations, could appropriate an amount equal to the capital stock and the bank know nothing of it for months or years, and until a final wind-up and general account was had.

3. The record discloses that the capital stock of this bank was $50,000, its undivided profits $23,116.63, its individual deposits $140,291.57, its certificates of deposits $14,682.75, making in deposits alone more than three times its capital stock.

Record, 44, 45.

Its discounts and demand loans averaged nearly $100,000 each.

Rec., 44, 45.

These presented ample opportunity and margin for an ingenious bookkeeper and embezzler to exercise his skill.

## IN THE MATTER OF THE CASHIER'S BOND.

This bond is dated January 1, 1893, and is in the penal sum of $20,000.

Rec., 6–9.

This bond was only in existence from January, 1893, to April 17, 1893, when Schardt died. The amount claimed on this bond is $22,964.17 of principal. This sum was abstracted by Schardt, as cashier, between January and April.

The bond recites:

"Whereas, the said employe has been appointed cashier at Nashville, Tennessee, in the service of said employer, and has been required to furnish security that he shall not be guilty of any FRAUDULENT act in the performance of his duties in said capacity by which the said employer shall suffer any pecuniary loss."

Later, by recitation, the bond undertakes to limit the liability of the guarantee company (1) to any act of fraud committed by the said employe in connection with the duties of said appointment, and constituting EMBEZZLEMENT OR LARCENY.

This bond contains also the following:

"Now, therefore, this bond witnesseth, that the said employe for and on his own behalf, and the said company fully relying on the truth of his statement and declaration contained in a certain document distinguished as employer's guarantee proposal No. 154,806, dated the 10th day of January, 1893, and signed Lewis T. Baxter, president, on behalf of the said employer, and lodged with the said company at its office in Montreal, and on the strict performance and observance hereafter, *by the said employer* of the contract thereby created, do hereby, respectively, severally, and jointly covenant with the said employer to reimburse unto the said employer, or his or their representatives or assigns, the amount of any loss not exceeding in the whole the sum of twenty thousand dollars, which, during the currency of this bond, shall be sustained by the said employer by reason of any act of fraud committed by the said employe in connection with the duties of said appointment, and constituting embezzlement or larceny—such reimbursement to be made within three calendar months next after proof shall have been given to the satisfaction of the directors of the said company, of the occurrence of such loss, and the proof thereof to include, if the company shall so require, an affidavit to be made or taken by the person for the time being entitled to the benefit of this guarantee, to the effect that he hath been actually

defrauded by the said employe, and that he suffers absolute and ultimate loss thereby to the full amount claimed hereunder, and that the contract created as aforesaid, hath been fully performed and observed on the part of the said employer."

Said bond also contains the following:

"Provided always that this bond and guarantee hereby granted or undertaken shall be subject and liable to the terms and conditions hereupon indorsed."

I shall notice only such of these conditions as are supposed to be material to this litigation, as follows:

"2. That said employer shall use all due and customary diligence in the supervision of said employe for the prevention of a default, and to that end shall cause an inspection or audit of his accounts to be made at least once in twelve months, and if the said employer shall, at any time during the currency of this bond, become aware of any act or default on the part of such employe, which would constitute a claim hereunder, and shall continue said employe in his service, without notification to the said company, the said company will not be responsible hereunder for any loss or default which may occur subsequent to said act or default of said employe.

"3. That any written answers or statements made by, or on behalf of said employer in regard to, or in connection with the conduct, duties, accounts, or methods of supervision of the said employe, delivered to the company either prior to the issue of this bond, or any renewal thereof, or at any time during its currency, shall be held to be a warranty thereof, and form a basis of this guarantee, or of its continuance.

"4. That the said employe has not, to the *knowledge* of said employer, been guilty of any serious dereliction of duty or default in this or any other service, or that his habits have been such as to incur said employer's censure previous to the issue of this bond.

"6. This bond shall extend to cover only such losses as may have been incurred by reason of the *fraud* of the said employe during the currency of this bond, and within twelve months previous to the notification to said company of any default hereunder."

This cashier's bond was issued upon what is called employer's guarantee proposal No. 154,806, and which is signed by Lewis

T. Baxter. I now quote from this all the questions and answers supposed to be material to this suit, omitting all immaterial.

Rec. 107.

"Ques. 3. Has he ever been in arrears or default in the bank's service, or, as far as you have heard inay previous employment?

"Ans. No.

"Ques. 4. Have you known or heard of anything unfavorable as to his habits or associations, past or present, or of any matters concerning him about which you deem it advisable for the company to make inquiry?

"Ans. No.

"Ques. 13. When were applicant's books and accounts, including cash, securities, and vouchers (if any) last examined, and by whom?

"Ans. December 31, 1892, by finance committee (where they found correct), of bank, and found correct.

"Ques. 14. In case of applicant's handling cash or securities, how often will the same be examined and compared with the books, accounts, and vouchers, and by whom?

"Ans. Not less than quarterly, and often monthly, by finance committee.

"Ques. 16. Will applicant handle funds or securities not subject to routine check or periodical examinations? If so, please describe their nature.

"Ans. No."

All the above and many other questions and answers are concluded by this general printed language:

"The above answers and representations are true to the best of my knowledge and belief." Dated January 10th, 1893. Signed. "Lewis T. Baxter. Official title, President."

The first assignment of error is:

"1. *The bank represented that it did not know of, and had not heard of anything unfavorable as to the habits or associations, past or present, of the employe upon whom it was seeking the issuance of the bond, yet at the same time the bank, and the particular officer making the statement for the bank, knew that the employe had been engaged in speculation, and had been a partner in a gambling concern while occupying a position*

*of trust in the bank, and no effort was made to verify his statement that he had sold out his interest in the bucket shop, and had ceased speculating."*

The court perceives that this bond makes an effort to create a *warranty* "in respects to all written statements or answers made by or on behalf of said employer in regard to or in connection with the conduct, duties, accounts, or method of supervision of the said employe, delivered to the company either prior to the issue of this bond, or any renewal thereof, or at any time during its currency, shall be held to be a *warranty* thereof, and form a basis of this guarantee, or of its continuance."

Baxter, the president, had said, in writing, that *he* had not known or heard of anything unfavorable as to Schardt's *habits or associations,* past or present, or of any matters concerning him about which *he* deemed it advisable for the company to make inquiry.

1. The court will observe that the declaration of Baxter concludes with this sentence:

"The above answers and representations are true to the best of my knowledge and belief." Signed. "Lewis T. Baxter. Official title, President."

The *bank* made no representation of any character unless this statement of Baxter be held to be [illegible] statement.

Let us inquire what is the legal effect of Baxter's qualification, by the use of the words, "true to the best of my knowledge and belief."

The authorities are generally, if not entirely agreed, that where such words occur, in order to avoid the policy, it must be proven that the declarant has been guilty of a *"willful untruth."*

1 Biddle on Ins., sec. 562, citing
Clapp v. Mass. Benef. Asso'n, 146 Mass., 519.
United Breth., etc., v. Kinter, citing France v. Aetna

Ins. Co., 94 U. S., 561; Ins Co. v. Gridly, 100 U. S., 614, and other cases.
National Bank v. Ins. Co., 95 U. S., 673.

Every reply made by Baxter to the questions submitted has this qualification, and in order that such answer shall be available and effective, defendant in error should show that in these answers he uttered a willful falsehood.

2. *"Unfavorable as to his habits or associations, past or present."* January 1, 1893, no man had better "habits or associations" than Schardt, so far as Baxter knew, or so far as the public knew. As respects his "past," Baxter had not seen the anonymous letter to Woodward, for, according to the most reliable testimony, it had not been written. Woodward did not resign until February, 1893. Its reception is fixed by the witness with reference to the time of that resignation.

This sends us back to Sykes' testimony, substantially. He says that in the summer or fall of 1892, he told Baxter what Schardt had said. Well, what had he said? "That at one time he had been interested in a brokerage association, but sold his interest, and that he had speculated to some extent, but had made money, but he had ceased to do so any more." It is nowhere shown that Baxter knew of the Kyle conversation at this time. Let us suppose that Baxter had heard by means of an anonymous letter that Schardt had, at one time, owned stock in a brokerage association, or that he had one or more transactions in speculating, these cannot be said to constitute "habits or associations," and it was *"habits and associations"* which this question asks about.

These cannot be said to constitute habits or create associations.

Aetna Ins. Co. v. Davis, 123 U. S., 739.
3 Joyce on Ins., sec. 2070.

There is a clause in the bond which must be read in this

connection, as it pertains to the same matter. It is: "That the employe has not, to the *knowledge* or *belief* of said employer, been guilty of any serious dereliction of duty or default in this or any other service, or that his habits have been such as to incur employer's censure previous to the issue of this bond." The question calls for Baxter's personal knowledge or belief. He had no *knowledge* is certain, and he said he had no belief which he deemed it advisable for the company to make inquiry about. The argument is that he should have had a belief, and that the court should so hold.

**"When a statement is made in good faith and from the best information the declarant has, it should not defeat a recovery, though it was untrue."**

Supreme Lodge v. Dickson, 52 S. W. Rep., 862.
(Tennessee case.)

**Falsehood cannot be predicated of an opinion, as to whether Baxter had heard anything concerning Schardt which *he* deemed it advisable for the company to make inquiry about.**

52 S. W. Rep., 862.

I deny that insurance or guarantee companies can select any person connected with a corporation or partnership, either its president, clerk, or porter, and put a lot of questions to him in respect to his beliefs about other employes, and whether the party questioned has a belief which *he deems* it advisable to publish, and thereby affect, in any way, especially forfeit, an indemnity bond given for the fidelity of the person inquired about.

This goes upon the theory that insurance or guarantee companies, by reason of this confidence game, can make some one its detective to run down every loose rumor in respect to some employe, no matter how ignoble the source or vehicle of the information.

Representations, expectations, belief or opinion, without fraud do not avoid a policy.

2 Joyce on Ins., secs. 1903–4, and cases cited.
Beham v. United States Guarantee Co., 7 Exch., 744; 21 L. J. Ex., 317.

II.

*The second assignment on the cashier's bond is*:

*"The bank procured the issuance of the cashier's bond by representing that the books and accounts of the employe, who had been teller for five years, had been examined and found correct to the end of his term of office; yet, at that time, the books of the bank showed a default of* $73,992.35, *in a bank with a capital of* $50,000."

This assignment is based upon question 13, put to Baxter, and his answer thereto. The question is: "When was applicant's books and accounts, including cash, securities, and vouchers (if any) last examined, and by whom?"

"Ans. December 31, 1892, by finance committee of the bank (were they correct), and found correct."

1. This answer was given under the qualification, "to the best of my knowledge and belief."

The evidence abundantly shows that the books and accounts had been examined December 31, 1892, by the finance committee, and found and reported by that committee to be correct.

**2. If this assignment has any merit, it arises, not out of the fact, but the mode, extent, and thoroughness of that examination, which I have discussed hereinbefore.**

3. The *examination* of December 31, 1892, was the one made under the teller's bond, where it is called "*inspected* or *audit*," and Baxter evidently believed that the question had reference to this, and answered accordingly. Personally, I do not believe

that it had that reference. That matter had been settled by questions 3 and 5, as follows:

"Ques. 3. Has he ever been in arrears or default in the bank's service, or as far as you have heard in any previous employment.

"Ques. 5. Is he, to your knowledge, pecuniarily embarrassed or insolvent, or is he in any way indebted to the bank."

I believe that the answers to the two questions above exhausted the inquiry, and that the question, 13, had reference to future renewals of this bond.

If I am wrong in this, then we have the company's own construction of the words, *"audit and inspected,"* in the teller's bond, and here the company defined them, or it, to mean *"examined,"* and under this light "examined and verified" as contained in the circular sent out annually, is much modified.

## III.

The third assignment on the cashier's bond is:

*"The court allowed $5,992.35 of overdrafts, 'allowed but not authorized,' as a part of the default, for which the company was liable, although the bond only protected the bank against a default 'constituting embezzlement or larceny.'"*

We have several replies to this:

First. Every item of embezzlement and larceny making up the large sum reported by the experts, was set out in what is known in the record as Exhibit X to the bill, and was a part thereof. Said Exhibit X only purports to show the *embezzlements and larcenies* of the cashier and teller. It makes no effort to exhibit any item that had been honestly dealt with, as shown by the books. Said exhibit occupies about six pages of closely printed figures in the record (see Rec., pages 13 to 18, inclu-

sive), and includes probably a little less than eight hundred items of money, varying in amounts. It took the experts some seven months to go through the books of the bank and cull out these dishonest items from the great mass of honest transactions.

An inspection of the exhibt shows that the experts set out the date of the dishonest transaction, the amount thereof, how it was accomplished; in brief, citing the book and page where and on which the item could be found. This exhibit was made a part of the bill. I will state just here that the guarantee company had been asked to put in an expert bookkeeper to assist in making out the exhibit, and declined to do so. Also the widow and administrator of Schardt had been likewise requested, and had done so.

This Exhibit X shows the default of Schardt, as cashier, to be $22,817.30, of which said item of $5,992.35 constituted a part. This Exhibit X constituted the proof of loss made to the guarantee company.

The following is the language of the bill:

"Complainant now charges that said Schardt, as such cashier, and during the currency of said bond, did, as shown by the report of said expert accountants and bookkeepers, and did, in fact, by acts of fraud committed by him in connection with the duties of his said office, and constituting embezzlement or larceny, take of said bank and appropriate to his own use, the sum of $22,817.30 without interest, and for which complainant is entitled to reimbursement under the terms and conditions of said bond."

The bill then proceeds to state that it did give notice, "and make the proof of the facts to said guarantee company."

While this Exhibit X was filed in court as a part of the bill, and a copy thereof in the hands of the guarantee company and its solicitors, it filed its answer, stating as follows:

"Respondent admits that after said bank made its assign-

ment to said Pryor, its affairs were examined, and it was discovered that said Schardt had *abstracted* from said bank a large amount of its money, a part of which was *abstracted* in the year 1890, a part of 1891, part in 1892, and a part in 1893, but the respondent does not admit that the amounts *embezzled* in each year are correctly stated in the bill," thus showing that defendant knew that every item of Exihibit X was charged as embezzlement.

The answer does not raise any issue on any item in said exhibit, or make the point now made, that the taking did not amount to an *embezzlement* or *larceny*. With the exhibit before defendant, the question should have been raised either in the answer, or certainly in the examination of witnesses, who testified to the correctness of the items in said exhibit as embezzlement or larcenies.

It is evident to the court that Exhibit X was the basis for the examination of the expert witnesses, and that it was not necessary to ask these witnesses if Schardt had embezzled or stolen such items *eo nomine*. The witnesses, the parties, and the attorneys went upon the theory that this exhibit contained the entire claim of complainant, and that each item was embezzlement or larceny. The experts headed the exhibit with these words: "Statement of shortage of John Schardt, cashier and teller of the Mechanics' Savings Bank & Trust Co."

The examination of the witnesses who made this exhibit, both original and cross, proceed upon the theory that "shortage" meant embezzlement or larcenies. Sometimes the word, "defaulter" is used. I give samples of the original and cross-examination:

Ques. 4, of McEwin. Witness was asked with reference to each and every one of the several hundred items of said exhibit: "Please state what was the character of these defaults, and of what did they consist as respects detention?

"Ans. They were extractions from the funds of the bank, made by Schardt, and were evidenced by the books kept by him, and covered on the books kept by him from detection.

"Ques. 5. Please state whether these abstractions or embezzlements were easily or readily detectible? etc.

"Ques. 7. How long were the bookkeepers and you engaged in ascertaining these abstractions?

"Ques. 9. In order to ascertain the facts of embezzlement of the funds of the bank? etc.

"Ques. 12. Please state whether the amounts, as stated above by you, were taken from the funds of the bank?

"Ans. These amounts mentioned were abstracted by John Schardt, etc."

On the cross-examination of this witness, the attorney for the company, Mr. Granbery, proceeding upon the idea that every item in Exhibit X was an embezzlement or larceny:

"Cross question 15. Please furnish statement marked Exhibit 4, showing in detail, the amount *embezzled* in each particular year, and each method."

The witness did so. It is alone in this Exhibit 4 that the aggregate of embezzlements, viz.: $5,992.35, done by means of overdrafts, first appears.

Record, p. 47.

In Exhibit X, each item of embezzlement is set out, but this does not, in every instance, show how it was done. Our friends on the other side wanted an exhibit showing, in brief, the amounts embezzled in each particular year, and the method by which each was accomplished. In this he was accommodated, said exhibits showing the amount of embezzlements each year, and the method by which it was done, such as "failure to credit deposit," "manipulating individual deposit," "failure to credit notes collected," "failure to enter deposit," etc., and then the items of $5,992.35, and the method by which it was done is stated to be "overdrafts allowed and not authorized." Our opponent's question called for embezzlement, and the method by

which it was accomplished. Now he seizes upon the method set out in the answer to show that it was not an embezzlement, but was money obtained in some mode discreditable, or otherwise, not amounting to an embezzlement.

I refer the court to the questions and answers of Prof. Jennings, who helped make out Exhibit X, and who, in response to the question, what was the result of the examination, said:

"I examined the books from September 9, 1890, to April, 1893, finding John Schardt's shortage during that time as teller and cashier, including interest, to be $107,182.12." He then sets out the amount for each year, and adds: "As cashier from January 1, 1893, to April 17, 1893, $22,964.17, and this item of $5,992.35, is included to make that sum."

Jennings stated the shortage of Schardt, as cashier, to be $22,964.17. He was then asked question 4:

"From whom had the money been taken or abstracted?
"Ans. From complainant bank.
"Ques. 5. Was the fact shown by books kept by Schardt, or which were under his care and keeping?
"Ans. Yes.
"Ques. 6. Was it shown to be money taken, or other valuables?
"Ans. As money taken.
"Ques. 7. How was Schardt shown to be connected with the embezzlement?
"Ans. The manipulations on the books were all shown to be in his handwriting."

The record abundantly shows that the whole testimony was taken upon the theory that Exhibit X showed only items of embezzlement or larceny.

2. On the trial and in the argument before the Circuit Judge (Clark), no such point was made, as the opinion reported in 68 Fed. Rep. shows. After Judge Clark had decided the case, and directed judgment to be entered for complainant, and the decree was prepared and submitted to the court, on July 1, 1895, the attorney for the company for the first time called the

attention of the court to this item, pointing out the present objection by error which he assigned August 1, 1895.

Neither the bill or the testimony made effort to hold Schardt or the company liable for "overdrafts," as such, but only for embezzlements or larcenies, but if Schardt made an overdraft on the bank in the name and behalf of another party, and without the knowledge of such party, or the bank, and himself took the proceeds and used them, it would be larceny or embezzlement on the part of Schardt, and the fact that it was called an "overdraft" by the experts would not make it a legitimate transaction, or deprive the transaction of its felonious character. Especially would this be true when the experts were asked to state the amount embezzled, and the method used by the embezzler.

The question concludes the particular criminality as that of embezzlement, and shows that the method by which it was accomplished was by overdraft.

This point was not made before the trial judge, and it was too late to assign it as error in the Court of Appeals, or in this court.

Danforth Dig., Vol. I., p. 1047, where all the cases are collected.

Marine Bank v. Fulton, 2 Wall., 252.

It is too late to present the question for the first time on a motion for a new trial.

Reagin v. Aiken, 138 U. S., 110.

Pacific Express Co. v. Malen, 132 U. S., 531.

We insist that under the rules of interpretation governing contracts of this character, that the bank would have the right of recovery for this item of $5,992.35, because of the ambiguity of the bond in its entirety, and that the guarantee company cannot insist that the act of fraud must amount to a technical "embezzlement" or "larceny."

The bond declares: "Whereas, the said employe has been appointed cashier at Nashville, Tenn., in the service of said employer, and has been required to furnish security that he shall not be guilty of any fraudulent act in the performance of his duties in said capacity, by which the said employer shall suffer pecuniary loss; and, whereas," etc. Later, and after many recitations in which the mind of the reader, especially of a layman, would have lost the connection, it says, it covenants to "reimburse unto said employer, or his or their representative or assigns, the amount of any loss, not exceeding in the whole the sum of twenty thousand dollars, which, during the currency of this bond, shall be sustained by the said employer by reason of any act of fraud committed by the said employe in connection with the duties of said appointment, and constituting embezzlement or larceny."

The sixth condition provides:

"This bond shall extend to cover only such losses as may have been incurred by reason of the fraud of the said employe during the currency and within twelve months previous to the notification to the said company of any default hereunder."

It is no answer to say, that, while the bond is ambiguous in respect to what acts the guarantee company will be liable for, in one place saying, "fraudulent acts, etc., by which the said employer shall suffer pecuniary loss;" at another place saying, "any acts of fraud, etc., constituting embezzlement or larceny," and at another place saying: "This bond shall extend to cover only such losses as may have been incurred by reason of the fraud of the said employe during the currency of this bond, and within twelve months," etc.

It will doubtless be replied to this that the first relates to the scope and obligations which the guarantee company is about to assume; that the next insertion relates to what it actually contracts to do, and that the third and last is a condition on the back of the bond relating to a limitation. It will not be denied, however, that the bond as a wole is ambiguous on this point, when read by the public generally, for whom it was intended.

This court has uniformly held:

"If, looking at all its provisions, the bond is fairly and reasonably susceptible of two constructions, one favorable to the bank and the other favorable to the surety company, the former, if consistent with the objects for which the bond is given, must be adopted, and for the reason that the instrument which the court is invited to interpret, was drawn by the attorneys, officers, or agents of the surety company."

American Surety Co. v. Paulz, 170 U. S., 133.
Imperial Fire Ins. Co. v. Core, 151 U. S., 452.

This bond more than once professes and pretends to secure the bank against loss by reason of the "fraud" and "fraudulent acts" of the employe, without regard to the technical criminal offense committed, and the public asked to accept it. The public have little or no concern, and less knowledge, of what constitutes the elements of larceny, embezzlement, or fraudulent breach of trust, or kindred crimes which go to make up the criminal laws of the country. The public wants indemnity against the wrongful and fraudulent appropriation and taking of money by parties intrusted, necessarily, with its custody and handling, as clerks, officers, etc., and to meet this want these bonds are made, accepted, paid for, and relied upon, and to this end they should be construed, unless there is a clear, unambiguous, and positive interdiction not reached by ingenious construction, but by the necessity of the very words used.

If the one part of the contract contradicts another part, then interpret the whole contract by the general purpose for which the contract has been made and entered into.

EDWARD H. EAST, *Attorney.*

# APPENDIX.

**Various Acts of the Legislature of Tennessee Licensing Dealings in Futures.**

ACTS OF 1887 (pamphlet act), CH. 1, P. 13.

After naming the various and different occupations licensed, it says:

"FUTURES.

"Each person, firm, company, or corporation dealing therein, and each branch or agency of such firm, company, or corporation, per annum, $1,000.

ACTS OF 1889, CH. 130, P. 247.

"FUTURES.

"Dealers in futures, and brokers dealing in futures, whether actual delivery is intended or not, each person, firm, company, or corporation dealing or doing a brokerage association therein, and each branch or agency of such company or corporation in cities, taxing districts, or towns, of thirty thousand inhabitants, or over, per annum, $1,000."

This act then grades the amount of the license, according to population, of all towns under thirty thousand.

ACTS OF 1891, CH. 25, P. 50.

This act is the same as the Act of 1889, set out above.

Acts of 1893, Ch. 89, p. 131.

This act is the same as the Act of 1889, Ch. 130, set above.

There is a proviso to this act to the effect that it shall not be construed to amend, repeal, or modify the criminal laws of the State. Approved April 30, 1893.

These and similar acts were construed by the Supreme Court, in 16 Pickle, 79, holding the license valid.